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OCTOBER 11TH-17TH 2003
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The problem with lavish executive pay

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Politics this week

Oct 9th 2003
From The Economist print edition

Suicide bomb

Israel bombed what it said was a terrorist camp in **Syria** after a female Palestinian suicide bomber killed 19 civilians, including four Arabs, in a restaurant in Haifa on the eve of Yom Kippur, the Jewish Day of Atonement. The United States mildly rebuked the Israelis and refused to endorse a United Nations resolution criticising them because it failed simultaneously to condemn the terrorist bomb. Arab governments, including Syria's, accused Israel of seeking to start a war in the region. A second suicide bomber wounded two Israelis in the West Bank.

See article: Another Yom Kippur, another conflict

Ahmed Qurei, the Palestinian prime minister appointed by Yasser Arafat last month, was said to have told Mr Arafat that he wants to quit his post. The Palestinian president, whom members of Israel's government want to remove, had earlier set up an eight-member emergency cabinet.

At least eight Iraqis died and many more were injured in a suicide bombing of a police station in **Baghdad**. Meanwhile, a Spanish diplomat was shot dead elsewhere in the city.

Turkey's government persuaded the country's parliament to vote for Turkish troops to be deployed in Iraq (but not in its Kurdish areas) to help American forces to keep the peace.

See article: Peacekeepers or troublemakers?

Iran's foreign minister, Kamal Kharrazi, said his country would continue to enrich uranium, despite calls from other signatories of the nuclear non-proliferation treaty, led by the Americans, for it to stop its enrichment activity and provide full information, by a deadline of October 31st, on its extensive nuclear programme.

Burundi's president and the leader of the country's main rebel group signed an agreement in South Africa to end a decade of civil strife.

Police in **Zimbabwe** arrested leaders of the country's main trade-union group for organising a demonstration against high taxes and prices.

Nigeria's trade unions called off a nationwide strike against a sharp rise in fuel prices after oil companies agreed to revert to the old price.

Arnie muscles in

AFP

Arnold Schwarzenegger was voted into office as governor of California after the incumbent Democratic governor, Gray Davis, was booted out of the job in the state's recall election. Despite last-minute claims that Mr Schwarzenegger, a Republican, had groped various women, he won the race to replace Mr Davis with 48.7% of the vote.

See article: Arnie and America's counter-culture

President George Bush said he hoped that the Department of Justice's investigation into the leaking of a **CIA** operative's name to the press would “hold someone to account”. White House staff complied with a

deadline to turn over papers relating to the case.

Louisiana held a primary election for governor. Bobby Jindal, a Republican and Indian-American, will face the Democratic lieutenant-governor, Kathleen Babineaux Blanco, in the run-off on November 15th. Whatever the outcome, Louisiana will have its first governor who is not a white male.

Russia's old-style election

The Kremlin's preferred candidate, Akhmad Kadyrov, won **Chechnya's** presidential election by a huge margin. The result was not a surprise; all of his main rivals were forced out of the race a month ago, and many ballot-boxes emerged with more votes inside than had been cast. The Kremlin's woman, Valentina Matvienko, also won election as governor of St Petersburg.

See article: Chechnya's presidential election

Financial markets are unworried by such democratic niceties. Three days after the Chechen election, Moody's, a credit-rating agency, upgraded **Russian debt** to investment grade, the biggest vote of confidence since the country defaulted in 1998.

Portugal's foreign minister, Antonio Martins da Cruz, resigned after being accused of using his influence to aid his daughter's entrance into a medical school. An education minister resigned last week over similar claims.

France was officially deemed by the European Commission to be in breach of the budgetary rules laid down in the stability and growth pact, after it failed to bring its budget deficit for next year below the ceiling of 3% of GDP. The commission will now make further recommendations, though it is likely to stop short of any painful sanctions.

See article: The stability and growth pact under stress

Sweden's prime minister, Goran Persson, chose another woman, Laila Freivalds, as the new foreign minister. She replaces Anna Lindh, who was murdered last month.

A new spirit of transparency pervaded **EU lawmaking**. Member countries agreed that, in future, legislative sessions of EU ministers can be televised. This will afford a brief snapshot of the decision-making process to viewers who do not immediately swtich off.

See article: The EU constitution

Nuclear option

Brazil announced plans to begin enriching uranium next year, initially for use as fuel in its two nuclear power plants, but eventually for export. The Brazilian science minister said the programme was designed to guarantee the country's energy supply. Brazil has large uranium reserves, but has hitherto enriched these only for research purposes.

Globovision, a television station in **Venezuela** opposed to President Hugo Chávez, was deprived of some of its transmission equipment by a government inspection. The country has also experienced a series of mysterious bombings, as Mr Chávez attempts to fend off efforts to eject him.

A car bomb exploded in Bogota, **Colombia**, killing at least six people. Nobody claimed responsibility.

Asia's free traders

The ten **ASEAN** countries, meeting at a summit in Bali, signed an accord to establish an EU-style free-trade zone by 2020. The agreement includes moves towards greater security co-operation. ASEAN countries also signed a non-aggression treaty with China, which renounces the threat or use of force to settle disputes and calls for greater economic and political co-operation.

See article: Noodle soup

North Korea said that it does not want Japan to be involved in any future talks on its nuclear programme. It said that Japan was an obstacle to peace and that it was not a trustworthy dialogue partner. North Korea also said, not for the first time, that it has completed reprocessing 8,000 spent fuel rods and is using the recovered plutonium to enhance its nuclear deterrent.

See article: North Korea's reforms

Land reclamation work in Victoria harbour will resume after a court ruled in favour of the **Hong Kong** government. Conservationists have criticised the plan to reclaim more than 55 acres of the harbour for a traffic scheme.

AFP

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Business this week

Oct 9th 2003
From The Economist print edition

Vivendi deal

Vivendi Universal agreed a final price for the sale of the French media giant's American entertainment assets to NBC, General Electric's media arm. Vivendi will get GE shares worth $3.8 billion and a 20% stake in the new company. GE will also take on debts of some $1.7 billion. Barry Diller, a minority shareholder in the assets, will not have the power to stop the deal, said Vivendi.

Britain's government approved a merger between **Carlton** and **Granada**, the two companies that control the country's largest commercial-TV network. The pair escaped stringent controls to temper their dominance of TV advertising. Shares in both companies soared; advertising agencies were not pleased.

See article: Owning the airwaves

Napster, an internet music-swapping system that closed two years ago after legal action by record companies, will re-open shortly. The new service will operate much like the old one but previous successes may not be repeated: customers will now have to pay for downloaded tunes.

Yahoo! said that revenues in the third quarter had jumped by 43% to $357m and that pro-forma profits had doubled to $65m. The leading internet portal benefited from a recovery of internet advertising.

See article: The return of TMT

Last orders

Scottish & Newcastle called time on pub ownership. S&N confirmed that Spirit, a British pub group with some 1,000 outlets, would buy its 1,400 licensed premises, restaurants and hotels for £2.5 billion ($4.2 billion). S&N intends to concentrate on brewing.

Shares in **Amersham** shot up by 16% after news emerged of a bidder (reported to be General Electric) for the British medical-equipment firm. Investors are hoping for a bidding war; the company has often been touted as an acquisition target for big drug and industrial companies.

Herbert Demel, formerly a senior figure at Volkswagen, was named as chief executive of the struggling car arm of **Fiat**. The Italian company's recent attempt to poach Martin Leach, the head of Ford Europe, for the post was stymied by a clause in his contract barring his employment by a rival company.

Chip off the old block

Motorola announced a spin-off of its ailing semiconductor business to concentrate efforts on making mobile handsets. The move comes shortly after an announcement of the departure of Chris Galvin, Motorola's chairman and CEO. Rumours abounded of disagreements between Mr Galvin and the board over the future of the chip business.

PeopleSoft said that buoyant demand for its products would propel third-quarter profits higher than previously forecast. The news pushed the software firm's shares higher and bolstered its chances of defeating a long-running hostile takeover bid from Oracle.

Alcoa, the world's biggest producer of aluminium, reported a 45% rise in profit in the third quarter compared with a year ago, to $280m. Cost cutting and increased demand contributed to the company's most profitable quarter in two years.

Getting on board

The Securities and Exchange Commission voted to give investors more say in **corporate governance**. It gave preliminary approval to a plan for shareholders to nominate board members through proxy statements, a company's official ballot paper. Shareholder groups claimed that the proposed system was too restrictive to produce much change. The measure is now open to public scrutiny.

Barclays, Britain's third-largest bank, appointed a new chief executive from within. John Varley, currently finance director, will take over from Matthew Barrett at the end of 2004. Mr Barrett will move up to become chairman.

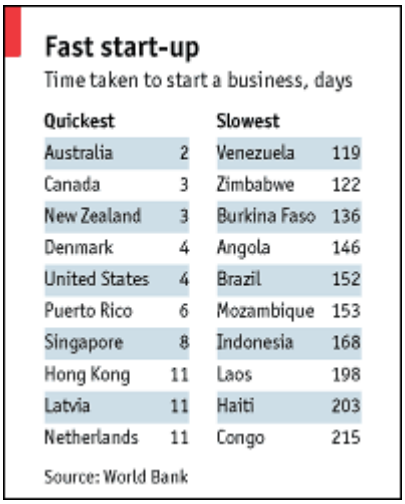
Royal Bank of Scotland signalled its intention to expand its presence in Ireland by offering *euro*887m ($1.0 billion) for First Active, a mortgage lender. RBS, which already owns Ulster Bank, hopes eventually to challenge Ireland's big banks.

America's Federal Reserve began distributing a new **$20 bill**, the first banknote to feature background colour. By introducing a splash of peach, and other security features, the Fed hopes to baffle forgers.

Down to business

A World Bank report analysing the obstacles to **doing business** in over 130 countries showed that light regulation promotes productivity, especially in developing countries. At the same time, a strong correlation exists between the ease of starting and running a new concern and the existence of a robust legal system. Predictably, the report concluded that onerous regulation retards economic growth.

See article: Poverty's chains



Fast start-up

Time taken to start a business, days

Quickest		Slowest	
Australia	2	Venezuela	119
Canada	3	Zimbabwe	122
New Zealand	3	Burkina Faso	136
Denmark	4	Angola	146
United States	4	Brazil	152
Puerto Rico	6	Mozambique	153
Singapore	8	Indonesia	168
Hong Kong	11	Laos	198
Latvia	11	Haiti	203
Netherlands	11	Congo	215

Source: World Bank

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Bosses' pay

Where's the stick?

Oct 9th 2003
From The Economist print edition

Something has gone wrong with bosses' pay. The solution has to lie with shareholders

Get article background

RUNNING a large public company is a stressful and important job. Thousands of employees and business partners and millions of customers and shareholders rely on the good judgment of corporate chief executives, who have to make decisions in a climate of constant uncertainty. Only the savviest and most determined need apply. Lately, though, these adjectives hardly spring to mind when company bosses are mentioned. For many, top bosses are not the toughest or most talented people in business, just the greediest.

A string of corporate scandals in recent years, from Enron to WorldCom to Tyco, have revealed senior executives apparently plundering their companies with little regard to the interests of shareholders or other employees. And even when no wrongdoing is alleged, huge pay awards are provoking growing outrage. Just ask Richard Grasso, the former chairman of the New York Stock Exchange, who went from folk hero to a symbol of excess almost overnight when it was revealed that he was due to receive $188m in accumulated benefits.

What is now causing the most indignation, in Europe as well as in America, are “golden parachutes” and other payments which reward bosses even when they fail (see article). Not only does it seem that bosses are being fed ever bigger carrots, but also that if the stick is finally applied to their backside, they walk away with yet another sackful of carrots to cushion the blow. Bugs Bunny couldn't ask for more.

The highest-profile cases of excessive pay, unfortunately, are not isolated exceptions. Bosses' pay has moved inexorably upwards, especially in America. In 1980, the average pay for the CEOs of America's biggest companies was about 40 times that of the average production worker. In 1990, it was about 85 times. Now this ratio is thought to be about 400. Profits of big firms fell last year and shares are still well down on their record high, but the average remuneration of the heads of America's companies rose by over 6%.

This one-way trend in top executives' pay has rightly raised eyebrows, on both sides of the Atlantic. The supply of good bosses may be short, but can it be that short, even during an economic slowdown and stockmarket slump? A recent poll in Britain found that 80% of people believe that top directors are overpaid. This summer customers boycotted a Dutch retailer, Ahold, to express disapproval of the pay awarded to that company's new chief executive.

Unions in America and Britain want governments to be more directly involved in regulating bosses' pay. But that cure threatens to be even worse than the disease itself. It would be much wiser to play to capitalism's strength—its flexibility—and to encourage shareholders themselves, the ostensible owners of companies, to sort the problem out. For too long the missing element in the setting of top executives' pay has been the active interest of shareholders. Only once that comes into play can the bargaining between boards and bosses become a more equitable affair.

Lavish pay-outs are not only costly in themselves but can also damage the long-term health of a company. Too many bosses have manipulated corporate results to fill their own pockets. Moreover, pay packages thought excessive or unfair can destroy morale among the rest of a company's workforce.

So what should shareholders do? For a start, big institutional investors can often make better use of the powers that they already possess. In Britain this year shareholders received the right to vote on top executives' remuneration. And yet at only one company (GlaxoSmithKline) did big investing institutions vote against an existing package—not an impressive performance if they are genuinely aggrieved.

Beyond Lake Wobegon

The pay-setting process is characterised by what has come to be known as the Lake Wobegon effect, after the novel “Lake Wobegon Days” by Garrison Keillor. All Lake Wobegon's children are said to be “above average”. Most boards appointing a new chief executive will seek the advice of a pay consultant, who will tell them the going rate. The trouble is, no board wants to pay the average for the job. The above-average candidate which directors have just selected as CEO, they invariably reason, deserves more. And so bosses' pay spirals upwards.

If shareholders want to break this mould they need to be far more diligent. Greater transparency about executives' pay will undoubtedly help, and moves in that direction in both America and Europe are to be welcomed. And yet shareholders must also exercise more say in choosing genuinely independent directors to select and monitor the CEO. Few public companies today in either America or Europe have a majority of independent directors. This week, America's Securities and Exchange Commission took steps in the right direction by proposing an increase in the power of shareholders to nominate and appoint directors. Once they have these powers, shareholders should make use of them.

That leaves the vexed question of how, and how much, to pay top bosses. There can never be any simple, single formula for this. Much will depend on the situation of each company. The boss of a firm in a stable or declining industry should probably not be paid in the same way as one in a fast-growing high-tech market. Some corporate boards ought to at least consider a return to what was once the norm in both America and Europe (and still is in Japan) and largely ditch pay-for-performance and instead pay largely through a straight salary (most lower-level employees are paid this way).

Yet most boards will probably stick with pay-for-performance of some kind. Whether in the form of options, the outright grant of shares, bonuses tied to criteria such as earnings or revenue growth, or some other means, pay should be explicitly aligned with the long-term interests of the owners, not short-term blips in share prices or profits. Whatever formula is chosen, some bosses are bound to try to manipulate it. This is why, in future, capitalism's pillars, the shareholders who own the company, will have to become more actively involved in choosing the directors who represent them and in policing what they do. Shareholders, after all, supply the carrots.

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Israel, Syria, and Palestine

Break this vicious circle

Oct 9th 2003
From The Economist print edition

Israel should not be blamed for hitting back at terror but must still be pressed to make changes

Rex Features

Get article background

AT FIRST glance, the Middle East this week looks more bleakly and bloodily dangerous than ever. The number of American casualties in Iraq continues to grow. Just before Yom Kippur, the Jewish Day of Atonement, a Palestinian suicide bomber, in one of the most dreadful attacks for some time, killed 19 civilians, including women and children, Arabs as well as Jews, in a restaurant in the Israeli port of Haifa. In response, Israel launched its first attack in 30 years against its neighbour, Syria, hitting what it said was a terrorist camp near the capital, Damascus, and raising fears that, if Syria hit back, the region might be sucked into a wider war.

In fact, it is unlikely, at present, that the conflict will spread (see article). And the shroud of gloom is not as uniform as it looks from afar. America's occupation of Iraq is proceeding messily but progress is being made. America's total of almost 200 combat deaths, in the short war and longer “peace”, is too many but not large compared with past conflicts. Most of the country, bar the so-called Sunni triangle where only a tenth of the population lives, is fairly tranquil.

Step by awkward step, the country is groping towards democracy: an assembly to draw up a constitution should take shape within a few months; elections leading to a genuinely Iraqi government, albeit underpinned for a time by at least some foreign troops, should take place next year. The agreement this week by Turkey to send troops to help keep the peace marks the first participation by a Muslim country in the struggle to stabilise Iraq. Many Iraqis feel aggrieved and disappointed by the continued lack of security and jobs, but progress, however halting, is visible. Even the electricity supply is said to be back to its pre-war level.

Horrors in the holy land

It is in Israel and Palestine, the second part of the Americans' effort to reshape the Middle East, that things are going bloodily backwards. There, the blame cannot be put entirely on one party. Israel is plainly entitled to hit back after terrorist bombs like the one in Haifa. And Syria's is indeed a nasty, repressive and near-bankrupt regime which, over many years, has connived at terror and has recently, after signs earlier this year that it would change for the better, been loth to help the cause of stability in Iraq as well as in Israel-Palestine. Nor have Arab governments in the region done anywhere near enough to discourage Palestinian groups like Islamic Jihad and Hamas that have committed appalling acts of terror on civilians.

In recent times, however, another obstacle to progress towards peace has been the Israeli government. Its decision to hit Syria was deliberately provocative, though whether it was wrong will depend on whether the bombed camp was indeed linked to the terrorist group behind the Haifa atrocity. More important, it has long been plain that the only basis for a lasting peace in the region is the creation of a viable Palestine state alongside a secure Jewish one. Yet it has become increasingly doubtful whether Israel's leader, Ariel Sharon, has truly accepted that simple formula. Yes, in the wake of America's victory in Iraq, he reluctantly agreed to follow an internationally-endorsed “road map” that plainly lays out the creation of a proper Palestinian state as the way to peace. And he acknowledged that Israel was

“occupying” the territory on which that state would lie. But since then, as on numerous occasions in his combative past, he has displayed virtually no desire for a genuine two-state solution. The most patent evidence to the contrary is his determination to build a wall between Arabs and Jews (see article).

Wall of misunderstanding

On the face of it, the wall has some merit. If it could prevent suicide bombers like the one who made mayhem in Haifa from entering Israel proper, well and good. Probably, however, it will not. And if it followed the pre-1967 “Green Line” that separated the West Bank—the bulk of any Palestinian state—from Israel proper, well and good too. But the route the wall is taking is quite different. It loops round Jewish settlements in the West Bank, biting huge chunks out of the Palestinians' territory. Not only does this look like a land grab, it also makes a would-be Palestinian state look woefully unviable. At the same time, the wall will make it much harder eventually to cut the number of Jewish settlers on the West Bank, without which there will be no lasting peace. Worse still, this creation of sullen Palestinian enclaves humiliates ordinary Palestinians, thereby increasing the number of extremists, many of whom reject the idea of two states and hold to the aim of a single state between the Mediterranean and Jordan: in short, the end of Israel.

Mr Sharon's wrong-headedness extends to his self-defeating demonisation of Yasser Arafat, the Palestinians' elected leader. For sure, Mr Arafat as a statesman has failed—most blatantly because he mishandled the chance to make peace with another Israeli prime minister, Ehud Barak, four years ago. But his oft-threatened “removal”, whether by assassination or by eviction and exile, will in no way encourage the emergence of a better Palestinian interlocutor. While a voluntary or natural departure might well bring forth a better leader, a martyrdom will not.

In the meantime, Mr Sharon is leading his people into a bloody cul-de-sac. The only force that can restrain him—by making him, for instance, reroute that wall—is America. Alas, George Bush has been indulgent, accepting too readily Israel's assertion that, since it is part of the global war on terror, it can carry on building settlements and walls until the terror has ceased. Mr Bush has himself called Israel's wall a “problem” in the pursuit of a two-state solution with the Palestinians, but he could be squeezing Mr Sharon harder to listen by cutting the massive amounts of aid America gives Israel each year in response to any settlement expansion or land seizures. To meet Israel's legitimate security needs, America and others could also offer to help police a border roughly along the old Green Line. That, rather than indulging Mr Sharon, would do more for Israel's long-term safety.

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Myanmar and ASEAN

Regime unchanged

Oct 9th 2003
From The Economist print edition

ASEAN should expel Myanmar, not congratulate its military dictators

AP

EVEN by the standards of ASEAN, it was a dismal performance. The leaders of the other nine members of the Association of South-East Asian Nations used their summit in Bali this week to ladle praise on to Myanmar for its “positive” and “pragmatic” recent policies. These, it appeared, meant the transfer of Myanmar's most famous citizen, the Nobel laureate Aung San Suu Kyi, from prison to house arrest, and the publication of a “road map” for democracy. Since a return to democracy has been promised by Myanmar's current junta ever since it took power in 1988, and since Miss Suu Kyi won an election in 1990 that has never been recognised, the Myanmar map looks as forlorn as the Middle Eastern one.

The disgraceful treatment meted out to Miss Suu Kyi is only the most obvious outrage committed by South-East Asia's most repressive and incompetent government. The generals do not just imprison thousands of political prisoners: they have turned their country into a place where life expectancy has collapsed to around 55, and growth has vanished. The World Health Organisation ranks the efficacy of Myanmar's health system at 190 out of 191 nations.

When Myanmar was admitted into ASEAN's ranks in 1997, the best defence against the charge that this was just a cynical attempt to exploit its trees and oil was that engagement with its odious regime might lead to reform. Anyone except the most terminally starry-eyed or self-serving ought by now to have concluded that this policy has failed. Yet it is hardly surprising that ASEAN membership has not led to more pressure: ASEAN's other members have their own shortcomings.

Indonesia had already let it be known that it was not interested in criticising fellow-members' domestic arrangements: Indonesia's president presides over a bloated army whose violations of human rights are widespread. The family of Thailand's leader has made a fortune from business dealings with Myanmar's generals. Two of ASEAN's members (Vietnam and Laos) are unreformed communist states, another (Brunei) an absolute monarchy. Ironically, the most sustained effort to secure Miss Suu Kyi's release has come from Malaysia, where a former deputy prime minister who dared to challenge his boss, Mahathir Mohamad, has been in prison since 1998.

A more robust attitude towards Myanmar has come from the United States, which has imposed tough sanctions on the regime, and the European Union, which maintains lesser ones. Yet so isolated is Myanmar that only its ASEAN neighbours, and China, have any prospect of bringing real economic pressure to bear. This they have refused to do. Sanctions were ruled out in Bali as “not helpful”. The simple step of suspending Myanmar from ASEAN until its record improves, which would express outrage without running the risk of harming the innocent, was not considered.

ASEAN has a few good deeds to its name (see article). It has lowered tariffs between its members, and aims for a full free-trade area by 2020 though progress has been slow. It has started to talk about regional security, though so far this is mostly just waffle. But even these achievements run the risk of being undermined by ASEAN's complicity in the gross abuses committed by one of its members.

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Russia

Putin power

Oct 9th 2003
From The Economist print edition

The West should stop pretending that Russia is a free democracy

Get article background

AP

"A COUNTRY in which democracy and freedom and rule of law thrive." That was how George Bush described Russia when its president, Vladimir Putin, visited Camp David two weeks ago.

Was the American president out of his mind? As two elections this week have confirmed, Russian democracy is a cynical joke. In Chechnya, all serious challengers to the Kremlin's preferred candidate, Akhmad Kadyrov, were encouraged or forced out of the race; voters and electoral officials were bribed or threatened; opposition supporters were intimidated and sometimes even killed; and, just to make sure, the vote itself was a fraud of a kind befitting an African dictatorship (see article). Meanwhile, Valentina Matvienko won the governorship of St Petersburg after an election campaign that was wholly biased in her favour. Mr Putin himself publicly endorsed her, a breach of election law that the head of the federal elections commission blamed on the media—after all, they had reported his remarks.

What about freedom? The state has taken over the main television channels one by one, and now their stodgy mix of slanted reports and dreary state events (always, of course, depicting a sparkling Mr Putin) uncannily recalls the Soviet era. The security services have swelled and their alumni are now filling government posts at all levels. Restrictions on travelling and settling in certain parts of Russia have been tightened. Human-rights and foreign-aid groups—among them America's Peace Corps—have been shut down or thrown out.

And the rule of law? The prosecutors' attacks on Mikhail Khodorkovsky, Russia's richest man, that began this summer have made one thing clear: in Russia, the rule of law is that those who rule are the law. Probably, Mr Khodorkovsky could, if fully investigated, be found to have committed misdeeds arising from the asset-grabbing privatisations that took place under Boris Yeltsin's presidency in the 1990s. But so could any other Russian oligarch. The legal system is clearly being manipulated against him, and so could be against anyone else.

Boom and bust

There is, of course, another picture of Russia, one painted by the investors flooding in at a rate not seen since its economic collapse five years ago. This Russia is booming. The country's biggest companies are approaching world-class standards of management. The bureaucracy and legal thickets that deter smaller firms are being trimmed. There are more investor safeguards. This week, Moody's, a credit-rating agency, raised its debt to investment grade. The best proof, ironically, stems from Mr Khodorkovsky's troubles: despite them, his oil company, Yukos, has completed a merger with Sibneft, and foreign oil giants, including ExxonMobil, are said to want to buy a stake in the new company.

These two pictures are not contradictory. And Mr Putin can take as much credit for the second as for the first. He knows that, to be strong, Russia needs both economic growth and good relations with the West, especially the United States. However, he also believes that Russia needs a tight leash. Mrs Matvienko and Mr Kadyrov would probably have lost clean elections. That makes them more beholden to Mr Putin.

The president's apologists say that this is the only way to run such a huge, poor and volatile country. When Boris Yeltsin let regional governors take more power, they made a mockery of federalism. Magnates such as Mr Khodorkovsky, who compare themselves to America's 19th-century “robber barons”, enjoy influence of which those men never dreamed. The television channels that some of them once owned were not havens of free speech, but tools for attacking the Kremlin. To thrive in the long term, Russia will have to be democratic, but for now this is the best one can expect.

Maybe. But if western leaders can ignore such issues as Chechnya and accept that Russia is not a democracy, they should at least stop pretending that it is.

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Development

What to do about slums

Oct 9th 2003
From The Economist print edition

Slums are growing fast. The solution must begin with property rights

Reuters

IN PAKISTAN they are *katchi abadis*, in Cuba *focos insalubres*, in India *bustees* and in Brazil *favelas*. Whatever the local name for slums, there are a lot of them and they are growing fast. A new report, “The Challenge of Slums” by UN-Habitat, the United Nations agency responsible for “human settlements”, says that in 2001 just under a billion people were living in slums—about a third of the world's city dwellers. In the last decade, urban populations in less developed regions increased by a third. On present trends, says the UN report, 2 billion people could be living in slums by 2030.

In Africa, many parts of the Middle East, Latin America and Asia, migrants are leaving farm land which is unable to support them, and arriving in cities which are unprepared to deal with them. This has been a long-term trend, and is unlikely to abate no matter how awful the slums become. In 1800, only 2% of the world's population was urbanised; by 2008 more than half of the world's population will be. Because such migration is so predictable, and long established, it might seem surprising that many governments are ill-equipped for it. But there is little new in that either: the now-rich countries fared just as badly when their cities first began to grow rapidly.

What can be done? Lessons from history make it clear what should not be done: ignoring slums or harassing the people that live in them through summary evictions and clearances. Although few governments openly advocate such repressive policies, arbitrary evictions are still common in many developing countries. In any case, slum eradication and resettlement create more problems than they solve. Most residents pushed out of their homes soon have little option but to return to the same area, because they need the work that drew them to the city in the first place.

Improving slums, rather than relocating their residents, is a much better approach. But in developing countries, resources to build new housing rarely exist. Instead, government-aided “self help” is more realistic. Loans for home improvement and investment in infrastructure are crucial for upgrading slums. But the central problem is that slum residents rarely have the formal rights to remain on the land they occupy. So they have no incentive to develop the land for the future, and are unable to raise the money to do so.

A stake in the future

Hernando de Soto, a well-known economist from Peru, has long advocated another solution: giving formal title deeds to the poorest slum dwellers. Possessing legal proof that they own the land beneath their home, however humble, gives poor people the means to raise finance for improving their dwelling and even, in many cases, for starting a business. The Peruvian government has issued well over a million property titles to the great benefit of impoverished families.

As the UN report points out, awarding titles is not always easy. Land laws in many developing countries are overly complicated, and government bureaucracies frequently inefficient or corrupt. But legal complications are often the unwelcome legacy of the colonial era, and should be untangled in any case. And bureaucratic inefficiency is a headache for reforms in every area, not just in that of slum policy.

The owners of much slum land have long since abandoned any serious claims to it. In other places, the land belongs to the government. In both cases, awarding a title to slum dwellers can be seen as a fair way to establish property rights, the bedrock of any prosperous society. If governments are brave enough to try it, slums could yet become an engine of growth in poor countries, rather than a crisis in the making.

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Letters

Oct 9th 2003
From The Economist print edition

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Unhappy breeders

SIR – Have you lost your mind? You seriously suggest that having more babies could be "desirable" for Europeans, lest we forgo the God-given right to economic growth ("Work longer, have more babies", September 27th). As an alternative you suggest that *Homo economicus* be compelled to stay at work for up to ten more years. Why not ask us to eschew retirement and die instead?

More people is just what the world does not need. As for the alternative—economic stagnation—what is so bad about that? Economic growth as measured by GDP is mostly an index of how fast we buy unneeded goods and services foisted on us by entrepreneurs who have "created markets".

David Book
Monterey, California

SIR – While it may indeed be necessary and even desirable for people to work beyond current retirement ages, you neglect to mention that many employers still worship at the altar of youth and find it difficult to accept that older employees can play a valuable role. This notion needs to be changed. The question is whether governments or companies will lead the way.

Jeremy Brinkworth
Haywards Heath, West Sussex

SIR – You say that governments will have to tread warily in encouraging more babies. I find this odd. There has been no shyness in encouraging people to have fewer.

Father Bryan Storey
Tintagel, Cornwall

Paradox lost

SIR – Having Epimenides, a Cretan, say "All Cretans are liars" does not create a paradox even if you adopt the strict binary definitions that a liar always lies, a non-liar never lies and every Cretan is one or the other ("This headline is [half] false", October 4th). If there is one Cretan non-liar, then Epimenides's statement is simply a lie, he is a liar and there is no paradox. In fact, there must have been such a Cretan or old Epimenides could never have uttered his famous line in the first place.

Bill Courtney
Long Beach, California

No means go

SIR – Charlemagne forgets a way which would convince both pro- and anti-Europeans of the merits of a referendum (September 27th). The mechanism is simple: make the only options in the vote either approval of the European Union's new constitution or exit from the EU. This should please both anti-Europeans, as they could at last campaign to leave the EU, and the rest of us, as we could then decide for ourselves if we want the constitution, rather than hearing that another country had already refused to ratify it. With a bit of luck the constitution would start a new process ("enshrinkment"?) by which the EU

could wave good-bye to a couple of member states that have been constant thorns in its side.

Adrian Taylor
Munich

Recalling the past

SIR – The main factor in the California recall election is the economically underestimated effects of charisma, or rather Governor Gray Davis's utter lack of it ("Engine trouble", October 4th). No one can calculate the cost of having uninspiring leaders but we would do well to consider past American presidents.

America struggled in the Depression, but eventually rebounded under brilliant Franklin Roosevelt, in spite of the war. We boomed under the spell of dashing young John Kennedy and declined under smart-but-creepy Richard Nixon and dull Gerald Ford. We muddled along under earnest Jimmy Carter and boomed, after a rough start, under ebullient Ronald Reagan. We fell into recession under the often-unintelligible George Bush senior and then boomed under charming Bill Clinton, before declining once again under plain-spoken George Bush junior. Mr Davis's problem is that he is perceived not only as ineffectual but insipid; a bad combination for any leader.

Bruce Warren Toms
San Carlos, California

If the suit fits...

SIR – You are wrong to ascribe the feelgood factor primarily to females ("The female feelgood factor", September 27th). Size, or perceptions thereof, matters immensely to men and your suggestion of standard sizing or bar coding is no substitute for adroit salesmanship or clever marketing. When in London recently, I went to buy a suit in the City. The assistant asked, "Does sir know his size?" I replied that in rude colonial Rhodesia where I had grown up, it was described in the trade as a "portly short". The assistant answered, "Ah, sir wants to see the directors' selection."

Mario dos Remedios
Harare, Zimbabwe

Educated answer

SIR – Calling the No Child Left Behind Act a "success" is curious ("Progress and confusion", September 27th). I have three children in the New York public-school system, where transparency has long been a feature. For years, every single school's performance details have been published in the local papers and on the Department of Education's website.

The only wrinkle added by the NCLB Act has been further classroom crowding. Children have flocked from failing schools to thriving ones but the thriving ones get no more teaching or physical capacity to handle the added influx. Hence, average class size in my daughter's school has increased from around 25 last year to some 35 this year. Programmes that have proved successful, such as self-paced maths, have been abandoned—no teacher can monitor 36 children all learning at their own speed. I cannot imagine what goal the NCLB Act could have other than to sabotage the parts of the public-school system that work well now.

Philip Teverow
New York

Historical perspective

SIR – Lexington's look at Condoleezza Rice and her tenure at the National Security Council fails to point out her remarkably wrongheaded view of history during the run-up to the Iraq war (September 27th). Ms Rice often compared Saddam Hussein to Hitler, and the situation as akin to the Munich crisis of 1938. Nothing could be further from the truth. Saddam's Iraq had been under international sanctions for ten years, had been defeated in the Gulf war of 1991 and had a no-fly zone in place over its air space. Hitler's Germany marched from one conquest to the next between 1936 and 1938. If Ms Rice has much of a political future beyond George Bush's White House, I fear for the welfare of her potential

constituents.

Paul Kellogg
New York

Kafka in America

SIR – I wish Lexington had quoted Gregor Samsa's sister in the article on George Bush's metamorphosis (October 4th). She says of the giant insect, “We must try to get rid of it.” Maybe after the election next November Lexington will describe how Gregor was brushed aside with a broom, after which his father said that now they could thank God.

Kathy Pertsch
Oberwaldhausen, Germany

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Israel's security barrier

A safety measure or a land grab?

Oct 9th 2003 | JERUSALEM
From The Economist print edition

AP

Israelis want a barrier to protect themselves from Palestinian terrorists. But the wall, now being constructed, is taking a strange route for that purpose

Get article background

AFTER every suicide bombing, the wall that Israel is building to seal itself off from the West Bank grows more popular with its people. This remains so, even though the latest assailant, a 29-year-old woman lawyer from Jenin who blew herself up in a restaurant in Haifa on October 4th killing 19 people, is said to have slipped into Israel through an unmanned gate in a completed section of the barrier.

Three days earlier, the Israeli cabinet had approved the army's plans for the full length of the barrier between Israel and the West Bank. These plans include deep incursions into Palestinian territory, to take in several large Israeli settlements, and a sweeping arc around occupied East Jerusalem that would sever Palestinians in the city from their West Bank hinterland.

One of the deepest incursions, encompassing the settlement-towns of Ariel and Emmanuel, is to be deferred for the moment because of American objections (though the settlements themselves will be fenced around). But Ariel Sharon, Israel's prime minister, believes that America's pressure will weaken with time, especially as its election grows close.

Mr Sharon was slow to succumb to public pressure for a security wall. At first, he sided with the settlers who feared that a physical divide—built, as the early pro-wallers envisaged it, approximately along the pre-1967 Green Line between Israel and the West Bank—would inevitably harden into the future political border, allowing the Palestinians much more land than he would contemplate. Later he came to see that pleasing his public, and keeping hold of land, were not mutually exclusive.

Israel's far-left opposed the barrier, on the grounds that such highhanded unilateral action by Israel must necessarily set back the prospects of a negotiated peace with the Palestinians. Once the wall was started in June last year, Israeli peaceniks joined in the outcry of Palestinians living along its first stretch, many of whom found themselves trapped, relying on the fitful diligence of Israeli soldiers to open gates in the wall to let them in or out.

But the political mainstream embraced the wall as a self-defensive measure to be implemented while the *intifada* continues, and the peace process is stalled. Keeping the terrorists out—and thus providing the

security that would allow for eventual talks—is the foremost consideration with most Israelis, trumping humanitarian worries about what is happening to Palestinians along the barrier's route.

The cabinet decision on October 1st, however, confirmed what the Palestinians have long been fearing and saying. Thanks to the sustained lobbying of Israel's settlers, and Mr Sharon's own identification with their cause, the barrier will not reinforce the 1967 Green Line, but will jut deeply and repeatedly into the West Bank. The pro-wall activists, say the settlers, have been hoist on their own petard.

The first phase of the barrier was completed in July. It runs 125km (78 miles) from Salem, a northern Israeli-Palestinian village, to the Elqana settlement south of Qalqiliya, 5km within the West Bank (other small sections of the wall have been built around Jerusalem). The first part of the northern barrier does run more or less parallel with the Green Line, although always built on the Palestinian side. As such, it resembles the barrier that encircles the Gaza Strip, which has proved pretty effective at preventing the infiltration of Palestinians from Gaza into Israel.

Swerving and dipping

But there the resemblance ends. The farther south the barrier runs, the more it starts to swerve and dip eastwards, like a vast territorial river, to envelop ten settlements, housing 19,000 settlers, built on occupied land. It is the extent and reach of these detours from the Green Line that convinces Palestinians that the barrier is less a project for Israel's security, and more a means to realise the colonial ambitions of the settler movement and its supporters.

The winding route of this first phase of the plan traps 15 Palestinian villages with 13,600 residents between the Green Line and the barrier. These unfortunates are prohibited from entering Israel to the west, and physically barred from reaching their lands, businesses and extended families in their West Bank hinterland to the east. A further 30,000 Palestinian farmers who live on the east side of the barrier are now cut off from their orchards, groves and farms on the western side.

Thousands more Palestinians have lost their access to schools, hospitals, government services and universities in the main urban centres of Jenin, Tulkarm, Qalqiliya and Nablus. According to B'tselem, an Israeli human-rights lobby, 210,000 Palestinians living in 67 Palestinian towns, villages and refugee camps have been “directly affected” by the construction.

The UN reports that 160,000 dunums (36,000 acres), or 2% of the West Bank's total land area, now falls on the Israeli side of the barrier, including some of the Palestinians' most fertile agricultural land, and prime West Bank water resources. About 10,000 dunums of privately owned Palestinian land has been confiscated or razed to clear the way for the barrier's route. Some 80,000 olive and citrus trees have been uprooted, and 37km of water pipes have been ripped up.

Palestinians' urban life has fared no better. Take Qalqiliya, a city where 42,000 Palestinians live, but which is the business and medical hub for 90,000 others from 32 neighbouring villages. The city is now caged on three sides by 13km of fences and blockades, including a 25-foot high concrete wall, topped by military watchtowers. There is one entrance for people and goods, and two agricultural crossings. Unemployment stands at 63% compared with 20% at the start of the *intifada*, 5,000 families are defined as destitute, and 80% of its residents depend on aid, either international or Islamic.

There is also a slow but clear exodus from the city, with many of the young and educated moving to the centre of the West Bank, or to Jordan and the Gulf. Qalqiliya's mayor, Mahrouf Zahran, believes as many as 8,000 Palestinians have left the town in the past three years. This, he insists, is the wall's basic purpose: “If Israelis had wanted security, they could have built it on the Green Line. But the aim is to strangle us economically, to force us to leave.”

Defenders of the wall say that all this dislocation is temporary only. “We are using a law to seize land for security reasons, and the law is very clear,” a defence ministry official told Israel's *Yediot Aharonot* newspaper last month. “When the security problem does not exist any more the land is returned to the owner.” Palestinians do not believe this to be true.

They point to the sheer extent of the barrier. On the section already completed, it is between 60 and 100 metres wide, consisting of concrete walls, electronic and razor-wire fences, trenches or ditches, plus, as a rule, three roads: one to trace infiltrators, another for army patrols and a third wide one for tanks. It has meant a big financial investment. The first phase is estimated to have cost the Israeli government $200m, working out at around $1.6m per kilometre. The final cost is incalculable, given how amorphous the plans still are. One Israeli analyst puts the price tag at $1 billion. This is hardly a temporary arrangement, say Palestinians.

They are also wary of the legal means Israel has used to construct the barrier, if only because they have experienced them before. Most of the land for the wall has been “requisitioned for military needs” by the army. These orders are valid until 2005, but can be renewed. Palestinian landowners can challenge the land seizures by appealing to Israel's legal adviser in the West Bank, and Israel's High Court of Justice. Dozens have done so since work commenced. But B'tselem notes that all the petitions have been rejected.

“Two things are certain about Israel,” says Muhammad Maraabi, the deputy mayor of Ras Atiya, a Palestinian village south of Qalqiliya, “It never returns your land and it never pulls down walls it puts up.” Ras Atiya is 3km from Alfei Menashe, a settlement built on confiscated Palestinian farmland in the early 1980s. Between village and settlement runs the barrier: a turmoil of bulldozed land, dynamited rock, coiled wire, ditches, a concrete wall, a tarred road and a tangle of razor wire.

Mr Maraabi says the village has lost 1,400 dunums to the barrier's construction, and that its route has cut the village off from 9,000 dunums of the citrus groves, cucumber fields and flowers that have been

its livelihood for close on 150 years. When the armistice lines were drawn after the 1948 Arab-Israeli war, Ras Atiya lost 1,000 dunums to the new Jewish state. Mr Maraabi is convinced that this current, larger expropriation will be similarly irreversible.

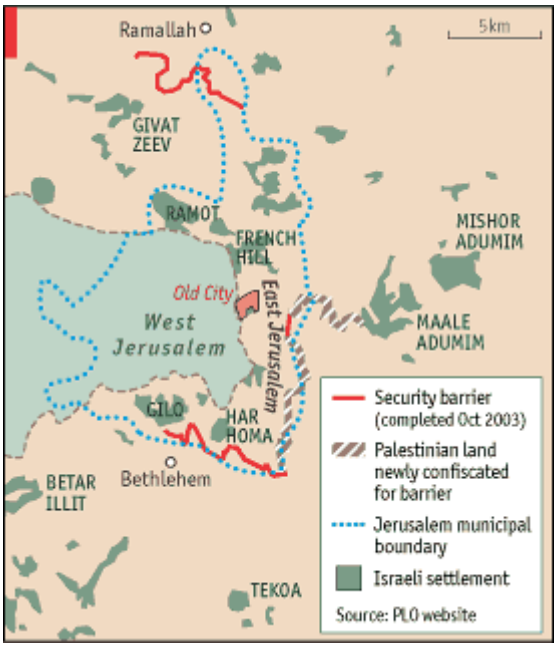
The army says that the problems will be eased when five “main” gates and 26 agricultural ones are installed along the barrier's route. But few openings have been built so far, and no money was allocated for them in Israel's 2003 budget. Instead, Palestinians gather each morning on the outskirts of their towns and villages in the hope that soldiers will enable them to breach the barrier. Others trek far over dirt roads and mountain passes. Some sleep in tents on their land. A few have abandoned their crops and greenhouses as no longer worth the upkeep.

It is a dangerous abandonment. In the West Bank, the Israelis use an old Ottoman statute in which private land unworked for three years can be claimed by the state. Since 1967, Israel has invoked this law to take over 60% of the West Bank as state land, to build 135 settlements and to transplant 400,000 of its Jewish citizens into occupied territory, including East Jerusalem. Palestinians fear that the same fate will befall the newly requisitioned lands.

The first phase of the barrier has been bad but Palestinians fear worse to come. The next phase of the western barrier may not, for the moment, include Ariel and other settlements deep in the heart of the northern West Bank, but it will certainly incorporate southern settlement-blocks, including Gush Ezion and the settlements near Hebron. Israeli analysts say this means that 80% of all West Bank settlers will be gathered on the Israeli side of the barrier. Palestinian geographers say this land grab amounts to Israel's de facto annexation of 10% of the West Bank.

Obliterating Palestinian Jerusalem

In the East Jerusalem area the entire 45km of planned wall will be up by early in the new year if construction continues at its present rapid pace. Broadly speaking, the wall will follow the line of the municipal boundary. But there's the rub. That line was hastily drawn in the immediate aftermath of the 1967 war, and the whole area encompassed by that arbitrary boundary was declared Israel's eternal and indivisible capital.



Tens of thousands of Palestinians found themselves residents of a nominally Israeli city (almost all declined a somewhat half-hearted offer of citizenship). They have become hundreds of thousands, with hundreds of thousands more living alongside them in village-suburbs to the north and east of the city, indistinguishable from the others save for the colour of their ID cards.

The municipal boundary has, in effect, been invisible. The proposed wall will now slice through several of these suburban districts, separating children from their schools, shopkeepers from their stores and family members from each other. Hours-long queues at frustrating, and often humiliating, checkpoints have already become a way of life for many Palestinian Jerusalemites seeking to move about in their own city.

Daniel Seidemann, a lawyer and Jerusalem civic activist, says the route of the wall is intended to obliterate the memory of Bill Clinton's proposal, accepted at the time of Camp David in 2000 by Israel's then prime minister, Ehud Barak, that Jerusalem's Jewish suburbs be part of Israel, and its Palestinian suburbs become part of a Palestinian state.

Mr Seidemann fears that, far from enhancing security in Jerusalem, the wall, with its inevitable dislocation of everyday life, will destabilise the city and lead to radicalisation among Palestinian residents. “It will deprive them”, he argues, “of their ability to be ambiguous. East Jerusalem has been largely quiet during the *intifada*. The wall, and the creeping militaristion of life in East Jerusalem, will bring people there to side with terror.”

Will there be a barrier to the east of the West Bank as well as to the west? Mr Sharon announced in March that construction of the eastern section of the barrier would begin, snaking first east and then south from Salem. It has not proceeded very far, either through lack of political will or through budgetary constraints. It will not need to be anything like the solid barrier to the west. Unlike the West Bank's western hills, the Jordan valley is sparsely populated. Palestinians can be separated easily from their eastern hinterland by simple fences, closed military zones or natural mountain ridges.

There is considerable ambiguity about what is being planned. Settler leaders in the vast central settlement-town of Maale Adumim, and the smaller ones that line the Jordan valley, say that they have had assurances from the prime minister that they too will be included on the “right side” of a barrier, whether it lies to the east for Maale Adumim. or to the west for the Jordan valley settlements.

“Sharon unrolled maps before me showing that all of the Jordan valley and Judean desert will remain under Israel's control,” David Levy, a settler leader from the Jordan valley, told *Yediot Ahoronot* in September. If he is right, that could mean an Israeli strip of land, 20-30km in width, running west of the Jordan river, the Palestinians' main gateway to the Arab world.

Improbable as this eastern barrier seems, it may be consistent with Mr Sharon's strategic vision. He has long argued that it is in Israel's vital interest to keep hold of a strip of land, between six and ten kilometres wide, east of the Green Line, a 20km-wide strip west of the Jordan border, and a “united” Jerusalem. He has spent much of the past 30 years initiating and supporting settlements that make such a hold on land irreversible.

Speaking at a conference last December, Mr Sharon gave the clearest account of his vision of a future Palestinian “state”. He said it should “overlap” with the West Bank area where the Palestinian Authority now has (nominal) security and civilian jurisdiction, “minus regions essential to Israel's security”. The worst-case scenario is that this would leave the Palestinians with about 40% of the West Bank, cut into three unconnected enclaves: one between Jenin and Ramallah, one between Hebron and Bethlehem, and a small circle around Jericho. Some of this disconnection is already in force: to journey from Bethlehem to Ramallah, a Palestinian has to get through two border crossings.

Mr Sharon has couched these projects in terms of “a long-term interim arrangement of non-belligerency”. He now says it is a Palestinian state “with provisional borders”. But it is essentially the same deal. It could be sustained only by outside aid, military containment and a docile, quisling Palestinian leadership. It would be neither independent nor viable, and would end the two-state solution as commonly understood.

A fence on the property line, it isn't

AP

Whether the barrier is built as currently planned depends to a critical degree on the position taken by the United States. George Bush noted pointedly and publicly during the summer that the wall was “a problem”. Mr Sharon, anxious not to anger him, devised the deferred solution for the Ariel-Emmanuel enclave.

But Colin Powell, America's secretary of state, said at the weekend that this was not satisfactory, and that American officials were having “intense discussions” about their response. The problem was not the fence itself, Mr Powell told the *Washington Post*, but its projected course. “If you want to put a fence on something that is a recognised border, the Green Line, then put a fence on your property line. But the

more you intrude in Palestinian areas, and the more it looks like it could be contiguous intrusion around large sections of Palestinian land that would prejudge subsequent negotiations as to what a Palestinian state may look like, that's a problem."

The *Post* had observed editorially several days earlier that "administrations have a poor record of preventing unilateral Israeli actions in the occupied territories". American officials are said to be examining whether the $1 billion projected cost of the wall could be deducted from the $9 billion in loan guarantees that the administration has extended to Israel.

This sanction alone, however, is unlikely to deter Mr Sharon and his ministers; America's deduction of Israel's outlays on new building projects in the settlements from the loan guarantees has by no means dissuaded the government from going ahead with such projects. Once a reluctant convert to the wall, Mr Sharon may now be using the overwhelming domestic support for it to pursue his own long-held territorial and strategic ambitions.

Creating a desolation

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California politics

Arnie! Arnie!

Oct 9th 2003 | LOS ANGELES
From The Economist print edition

EPA

A comfortable victory, but a lot of promises to keep

Get article background

“FOR the people to win, politics-as-usual must lose.” As California's voters on October 7th swept dreary Gray Davis from the governor's office, Arnold Schwarzenegger, Austrian-born body-builder turned American movie-star, had a pithy slogan to celebrate his instant ascent to the pinnacle of Californian political power. Adoring supporters cheered their hero, and a swarm of Kennedys—the governor-elect is married to JFK's niece, Maria Shriver—was on stage to embrace him. Congratulatory phone calls were soon to come from President George Bush and even Nelson Mandela.

So much for the immediate glow of victory. But in the aftermath of the first recall election in the state's history, the question is whether Mr Schwarzenegger's slogan has any staying power. The new governor is a Republican in a state where all other elective offices are held by Democrats. Of the state's 40 senators, 25 are Democrats; of the 80 assemblymen, 48 are Democrats. Politics as usual could easily mean an ineffectual governor, immobilised in his efforts to pass a state budget that he must present to the lawmakers on January 10th and embarrassed by his campaign pledge to lower car taxes while not raising others (for which, in any case, a two-thirds “super majority” is needed).

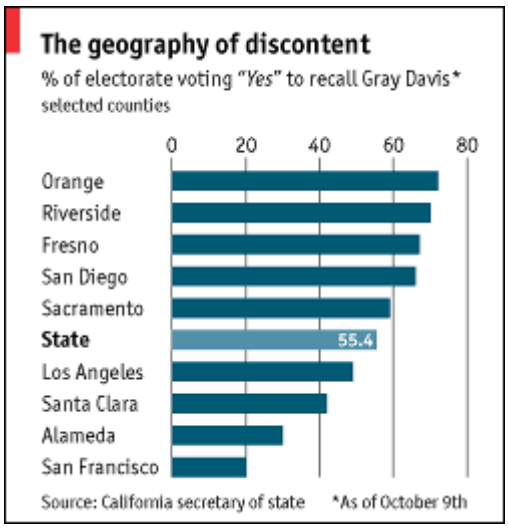
Hence Mr Schwarzenegger's readiness, just days after he had brandished a “house-cleaning” broom before the Sacramento Capitol, to offer olive branches to all and sundry, paying tribute not just to California's Democratic senators, Dianne Feinstein and Barbara Boxer, but also to a Gray Davis who had accepted defeat with grace. The next day the new governor noted that he had been able to work with both sides of the political divide in passing last year's Proposition 49, a Schwarzenegger-inspired law to provide state money for after-school programmes: “I don't think one should take the negative approach. The legislators have gotten the message.”

They certainly should have. One part of the message is that Governor Davis was an entrenched member of the political establishment who had done nothing illegal, nothing morally beyond the pale. Yet a campaign to recall him began just three months after he had been elected last November for a second four-year term. In the ensuing election this week it is estimated that around 60% of the state's 15.4m registered electors turned out to cast their votes, and 55% of these voters chose to sack him. He could not shake off his image as an obsessive fund-raiser, in hock to the unions and other “special interests” and, by somewhat illogical extension, wholly responsible for California's budget difficulties and fragile economy.

The second, more important, part of the message is that the voters chose as his replacement a man who deliberately presented himself as an amateur. Moreover, they chose Mr Schwarzenegger by a convincing margin, despite a last-minute media storm about sexual groping and Nazi proclivities. Either the voters detected a smear campaign by the well-practised Mr Davis, or they accepted that Hollywood movie-stars do irresponsible things from time to time. In the end, as many women voted for Mr Schwarzenegger as voted against him.

But the truly impressive feature of Arnold's triumph is that in a field of 135 candidates, from a porn star to a dwarf actor, he won more than 48% of the vote. Cruz Bustamante, the state's Democratic lieutenant-governor, came second with just 32% of the vote. In third place, with a little more than 13%, came Tom McClintock, a conservative Republican state senator who stayed in the contest despite fears that his presence would deliver victory to Mr Bustamante. The overall arithmetic, therefore, is simple enough: in this bizarre, overcrowded election Mr Schwarzenegger, derided by his critics as a man with scant knowledge of the issues, won enough votes to have political and popular legitimacy—not least because his share of a bigger vote was larger than Mr Davis's winning share last November.

The critics could, of course, still be right. Throughout his campaign, Mr Schwarzenegger took obvious pains to avoid hard questions. His chosen format to reach the voters was a mix of simplistic TV commercials and appearances on mass-audience TV shows with fellow luminaries such as Oprah Winfrey or Larry King. Indeed, he was willing to take part in only one TV debate with the other main candidates—which he was deemed to have won by virtue of not having obviously lost.



Yet the critics have rushed too soon to judgment. His career is surely testament not just to extraordinary ambition but also to an ability to fulfil that ambition. Moreover, he is astute enough to surround himself with those who can help him. Falling in love with, and marrying, an attractive member of the nation's most famous Democratic family explains an appeal that reaches across party lines. Unlike the Republican base, Mr Schwarzenegger is socially liberal; but the Republican base is reassured by his fiscal conservatism. One of his economic advisers is Warren Buffett, America's richest stockmarket investor; one of his economic heroes is the Nobel laureate, Milton Friedman.

What worries non-Republicans, however, is that the new governor, for all his commitment to heal California's divisions, will become a proxy for the last Republican governor, Pete Wilson. After all Mr Wilson has been a campaign adviser, as have some of his aides. This, the Democrats mutter mischievously, is the man who embraced anti-immigrant policies in the 1990s and so helped make the Republican Party unelectable in the state.

Yet those worries are probably overdone. Mr Schwarzenegger may be promising to stop the granting of car licences to illegal immigrants, but he does so on grounds of national security, not race—and many of California's Latinos and other ethnic minorities agree with him. Moreover, this week he voted with most Californians, including minorities, to defeat Proposition 54, which would have stopped the state from gathering statistics by race or ethnic origin.

The real worry is that Mr Schwarzenegger and his transition team are promising the impossible. Can the new governor really reverse the car-tax increase? That would immediately widen by some $4.2 billion the underlying $8 billion budget deficit that faces the incoming governor. Worse still, the courts might rule that certain “deficit bonds”, approved by the legislators to help close this year's deficit, are unconstitutional, which could potentially double Mr Schwarzenegger's problem. Most pertinent of all, can he really keep his promise not to raise taxes?

Mr Schwarzenegger exudes optimism. First, let an independent audit assess the full extent of the budgetary problem and identify waste. Then, let the lawmakers attract business back to the state by cutting regulations and cracking down on the abuse of the workers' compensation system (insurance premiums for employers have soared in the past few years). Finally, let a Republican governor demand from a Republican-dominated Washington a fairer deal for California, a state that consistently gets back less from the federal budget than it pays in.

Too good to be true? Quite possibly. But a former movie actor who became a Republican governor of California also promised not to raise taxes, raised them, and went on to become president. Could history repeat itself? Not if the constitution, banning a foreign-born president, remains as it is. But if Senator Orrin Hatch of Utah has his way, the constitution will eventually be amended—and President Arnie has a nice ring to it. In the meantime, Governor Arnie had better hope his ambitions are not derailed by lawsuits from affronted women, or, after the required six-months' cooling-off period, by a recall campaign from Democrats too embittered to accept his olive branch.

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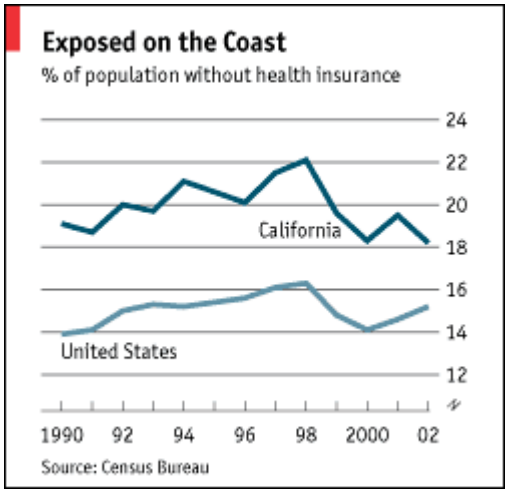
California health care

Gray's anatomy

Oct 9th 2003 | SAN FRANCISCO
From The Economist print edition

He may have gone; the state's new health-care plan hasn't



ON OCTOBER 5th, the soon-to-be-ex-governor of California signed a new law on health-care coverage. According to the Kaiser Family Foundation (KFF), California has 6.7m people without health insurance, roughly a fifth of the population. About 80% of these are people, or their dependants, whose employers—faced by rising insurance premiums—may not offer health-care coverage, or who choose not to take it up.

This will change under the new law. By 2006, firms with more than 200 employees will have to stump up 80% of the health-insurance costs of their employees and their dependants, or pay into a public fund which will administer these benefits. Their workers will be required to contribute the remaining 20%. By 2007, firms with 50-199 employees will be obliged to provide the same for employees only. Tiny companies—those with 20-49 workers—will remain exempt unless the state can come up with some form of subsidy to help them pay.

The new law will extend health-care insurance to more than 1m Californians, according to the UCLA Centre for Health Policy Research. Estimates of cost vary greatly: $1.4 billion a year, say supporters; closer to $11 billion, say some opponents. But, as Alina Salganicoff of KFF points out, the price of not having health insurance is substantial too, as neglected conditions become chronic and costly.

Although many employers are persuaded by this, they resent being forced by the state to foot the bill. According to Richard Costigan, chief lobbyist with the California Chamber of Commerce, the new law is a “job killer”, coming on top of hefty increases in workers' compensation, unemployment insurance and energy costs which already make the state a less attractive place to do business. A few firms have said they will leave California, and some have changed their plans; Wal-Mart, for example, still plans to expand there, but may hire more part-time employees, who are exempt from coverage under the new law, rather than full-time workers.

The governor-elect, Arnold Schwarzenegger, opposes the new law as too costly and cumbersome for business. California's Chamber of Commerce is considering taking the state to court, and has already filed a referendum to repeal the legislation. In the meantime, however, the new law moves California to the forefront of states, such as Hawaii and Maine, trying to come to grips with America's 43.6m uninsured people. The next step may be a federal solution, with bills before Congress to provide tax credits for health insurance and Democratic presidential hopefuls putting forward schemes to cover the uninsured. California, as usual, may be setting a trend.

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Weapons of mass destruction

Cutting both ways

Oct 9th 2003 | WASHINGTON, DC
From The Economist print edition

Both critics and opponents feel vindicated by the Kay report

THE interim report by David Kay, the administration's chief weapons inspector in Iraq, continues to reverberate round Washington. Most newspapers and broadcasting networks described the findings in broadly the same way: no banned weapons discovered. Democratic politicians from Senator Edward Kennedy to Nancy Pelosi, the party's leader in the House of Representatives, say this shows that the threat from Saddam Hussein was never imminent, and that war was not justified.

Yet the inspectors found programmes for a range of undeclared unmanned aerial vehicles. They uncovered new research on biological agents; a previously unknown complex of laboratories with equipment for research into chemical and biological weapons; evidence that Iraq was making fuel for banned Scud missiles and advanced design work for (also banned) long-range missiles that might have been deployed but for the invasion. Hardly evidence Iraq had given up its weapons programmes.

Both George Bush and Colin Powell leapt on these findings. The president said the report showed that Saddam had been “a danger to the world”. The secretary of state claimed it showed that “we and our coalition partners were right to eliminate...his regime.” How did the same document produce such opposing reactions? And which are more reasonable?

The report, of course, was tentative. Surprisingly, the inspectors have so far been able to examine only ten of the 130 or so storage sites where Saddam's regime kept its weapons. The conclusions were necessarily qualified, which made it easier for both sides to interpret them in the light of preconceived notions.

In some ways, the report does vindicate critics who complained that the administration misled the public with its claims about weapons stockpiles. In a speech in Cincinnati in October 2002, Mr Bush said that “the Iraqi regime...possesses and produces chemical and biological weapons. It is seeking nuclear weapons.”

But, according to Mr Kay's testimony to Congress, “Iraq's large-scale capability to develop, produce and fill new CW [chemical weapons] munitions was reduced—if not entirely destroyed—during Operations Desert Storm and Desert Fox.” And “to date, we have not uncovered evidence that Iraq undertook significant post-1998 steps to actually build nuclear weapons or produce fissile material.” Democratic senators had a point when they asked what intelligence Mr Bush had used when he made his claims: was it wrong, or was it hyped?

On the other hand, America's formal grounds for war never referred to weapons stockpiles. Nor did they refer to any “imminent threat”. In this year's state-of-the-union address, the president said it would be dangerous to wait until threats became imminent. And the congressional resolution authorising the use of force talked only of Iraq's continuing weapons capability.

The resolution also justified action unless Iraq complied with various United Nations resolutions and fully accounted for its weapons programmes. The Kay report provides a ton of evidence that Saddam's regime was hiding its existing weapons programmes, and some evidence that it was working on new ones as recently as the end of 2002. In that sense, Mr Bush and Mr Powell can claim that the report vindicates them.

The hard question is what the report implies about the UN's previous regime of sanctions and inspections—a regime the French, among others, believed would contain Saddam. The fragmentary nature of the weapons programmes suggests that containment had stopped large-scale weapons-making.

At the same time, the existence of banned missiles and the continuing development of new weapons suggests that Saddam was preparing to quickly restart his programmes once the UN inspectors were gone. Perhaps the next report will cast light on that conundrum.

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Iraq policy

Condi's victory

Oct 9th 2003
From The Economist print edition

At least, some see it that way. Others don't

Reuters

Getting his ear again

IF PROOF were needed that George Bush is unhappy with the way things are going in Iraq, it came in a confidential memo sent on October 2nd to Colin Powell, the secretary of state, Donald Rumsfeld, the secretary of defence, and George Tenet, the head of the CIA. The memo announced the formation of an "Iraq Stabilisation Group" to be run by Condoleezza Rice, the president's national security adviser, which will oversee terrorism-fighting and reconstruction in that benighted country.

Mr Bush made the plan public two days later, though not before Ms Rice had briefed the *New York Times* and had given the impression, somehow, that the reorganisation was a White House victory over the Pentagon. Immediately, Pentagon officials were mobilised in all directions. Some, including the secretary of defence himself, said that Mr Rumsfeld had not been consulted; others claimed that the new group was partly his creation; all stressed that the National Security Council had acquired no new powers by this, and that Mr Rumsfeld had lost none. In fact, the secretary wanted the confidential memo made public, just to prove his point.

Ms Rice's tenure at the NSC has been marked by a certain ceding, or losing, of authority to the Departments of State and Defence. It could certainly be argued that, by previously delegating power to the Pentagon over Iraq, she has helped to create the chaos her group is now in charge of calming. Still, a measure of her victory in this instance may be how loudly Mr Rumsfeld is reacting.

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The job market

New ideas needed

Oct 9th 2003 | WASHINGTON, DC
From The Economist print edition

Why many Americans are staying out of work

FEW statistics are followed more closely in George Bush's White House than the monthly jobs figures. In 1992, unemployment cost his father the election; the son has presided over more than 2.5m job losses. Small wonder that the White House jumped on the latest report, released on October 3rd.

It showed that non-farm payrolls rose in September, the first rise in eight months. At 57,000, the net number of new jobs created was barely half the 125,000 or so needed to keep up with new entrants into the labour force; but at least it was not a drop. Better still, August's job loss number was revised down by more than half. “Things are getting better,” said Mr Bush.

Reuters

Structural gloom

Are they? One month of modest employment growth hardly proves the end of “the jobless recovery”. Nonetheless, there are reasons for hope. One is that all of the increase in September's jobs came from the private sector, much of it from a rise in the number of temporary workers. The number of temporary jobs has risen for the fifth month in a row.

Hiring more temporary workers often precedes a rise in permanent jobs as economies emerge from recession. According to Richard Berner, an economist at Morgan Stanley, America's firms have spent the past two years trimming their workforces, after taking on too many employees during the bubble years of the late 1990s. With the excess cut out, and profit margins bigger, he reckons hiring should start again.

The pace of job growth, however, may well continue to lag behind that of previous post-1945 recoveries. This is because America's recent slowdown was no ordinary recession. Structural changes in America's economy—such as technological innovation and moving production abroad—have played a far bigger role than before in job losses. Rather than temporarily laying off workers as demand slowed, firms have been getting rid of them entirely. Those dismissed have to find jobs in new firms and new industries, which takes much longer than simply returning to an old employer.

In a recent study, Erica Groshen and Simon Potter, two economists at the Federal Reserve Bank of New York, carefully examined the relative importance of cyclical and structural factors in the labour market. They point out that temporary lay-offs, when a worker is laid off during a recession but later returns to the same employer, played a significant role in four recessions before the 1990s. In the two most recent downturns, those of 1990-91 and 2001, they figured little.

The two economists also tried to measure whether job losses were due to cyclical or structural factors. If a job is lost because demand for the firm's product is temporarily low, then the job should come back as the economy begins to recover. But if a job is lost because a firm or industry is structurally in decline, then it never returns. In the sharp recession of the early 1980s, they found that job losses were split almost evenly between cyclical and structural changes. In the most recent slowdowns, however, most job flows were due to structural changes. By 1990-91 almost 60% of America's workers were in industries undergoing structural adjustments. By 2001 that figure was almost 80%.

This highlights two important points. First, it may well take longer than expected for the jobs figures to

rise, since they will have to be new jobs, often in new industries. Second, today's trend towards structural rather than cyclical shifts is an intensified version of a phenomenon already evident in the 1990-91 slowdown. In one way, this bodes well: although it took more than a year for job growth to pick up in the early 1990s, about 18 months into the recovery employment growth soared.

Given that America had more cyclical excesses to work off this time, and that structural shifts are even more important than in 1991, employment may well take longer to rise than it did in the early 1990s. But rise it eventually should.

Time, unfortunately, is not on Mr Bush's side. With the presidential election little more than a year away, the White House needs to point to job increases now. Unfortunately, in their haste for results, both Mr Bush's team and his Democratic rivals are pushing wrongheaded ideas. The politicians' focus has been on trying to slow down the pace of structural change, particularly in one area, foreign competition. China—source of soaring imports and the place to which many American firms shift their production—is cast as the chief villain.The pressure is on for China to revalue its exchange rate or, say many lawmakers, face punitive tariffs.

Alas, the attempt to slow structural change in American industry will not stop there. The fear of losing service-sector jobs to foreigners is close behind. A study by Forrester, a business research group, suggests that the number of such jobs that will be outsourced to places such as India is likely to rise from 400,000 today to 3.3m in 2015. Already some states are trying to resist this by ordering state agencies not to use call centres and the like in India.

It would be better to address the factors that depress American hiring directly. One good place to start would be the rising non-wage costs of employing permanent workers, especially health-care costs. After slowing in the mid-1990s, these are soaring again, at double-digit rates since 1998. Finding a way to control health-care costs would be a far more sensible way to help America's workers than bashing China.

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Terrorism and the law

Are the rules being bent again?

Oct 9th 2003
From The Economist print edition

A judge says an accused terrorist can call the witnesses he wants. No, he can't

A FEDERAL judge has ruled that prosecutors may not seek the death penalty against Zacarias Moussaoui, the only person in the United States to have been charged so far in connection with the September 11th terror attacks. Nor may they present any evidence linking this so-called “20th hijacker” with the planning or execution of the attacks. The ruling, by a district judge, Leonie Brinkema, came after the federal government refused to allow Mr Moussaoui to question al-Qaeda suspects who, he claims, could prove his innocence. The government says it will appeal.

Mr Moussaoui, a 35-year-old Frenchman of Moroccan descent, was first arrested in the United States in August 2001 on minor immigration charges. It was not until after the suicide hijackings the next month that investigators began to take a keener interest in the Muslim trainee pilot being held in a Minnesota jail. Three months later Mr Moussaoui was charged on six counts of conspiracy—four of them punishable by death—to commit acts of terrorism, aircraft piracy, use of weapons of mass destruction, destruction of aircraft, murder of government employees and destruction of government property.

Although he admitted being a member of al-Qaeda, Mr Moussaoui claimed he knew nothing about the attacks until after they had occurred. In an attempt to prove his innocence, he sought to question three key al-Qaeda prisoners, including Khalid Sheikh Mohammed, the alleged mastermind of 9/11, and Mustafa Ahmed, its alleged financier. In two rulings earlier this year, Judge Brinkema ordered that he should be allowed to question by satellite link the three men, all being held at secret locations outside the United States. The government has refused to comply, arguing that national security could be jeopardised by the disclosure of confidential information.

In her latest ruling, delivered on October 2nd, Judge Brinkema said the government could not “maintain this capital prosecution while simultaneously refusing to produce witnesses who could, at a minimum, help the defendant avoid a sentence of death”. But she refused to take the widely expected step of dismissing all charges against Mr Moussaoui, who could face life imprisonment if convicted of the charges still pending. Her desire to keep the case under civilian jurisdiction appears to have been among her reasons for wishing to continue with a truncated trial. “This case can be resolved in an open and public forum,” she declared.

Among the options now facing the government is the possibility of transferring the trial to a military tribunal whose rules, including the right to extensive hearings behind closed doors, would be likely to help the prosecution. But this would attract widespread criticism. The government is already under attack for its treatment of some 660 al-Qaeda and Taliban suspects held at Guantanamo Bay, an American naval base in Cuba, where they are supposed to be awaiting trial before special military courts. Although some have now been detained for over 21 months, no charges have yet been brought. Nor have any of the prisoners, who include citizens of some of America's closest allies, had access to a lawyer or a consular official.

Despite the criticism, the American government insists the Guantanamo Bay detainees are not prisoners of war but “enemy combatants”, who are being held outside strictly-defined United States territory (the Guantanamo base is leased in perpetuity from Cuba) and therefore have no rights under either the Geneva Conventions or the American constitution. Last month Donald Rumsfeld, the secretary of defence, seemed to confirm suspicions that the government does not wish to bring these prisoners to trial. “Our interest,” he said, “is not in trying them and letting them out. Our interest is in—during this global war on terror—keeping them off the streets, and so that's what's taking place.” But that war could go on for a very long time, perhaps for decades.

The government insists the Guantanamo prisoners are being treated “humanely”. All now have individual indoor cells, proper beds, washing facilities and toilets. In July six of them, including two Britons and an Australian, were said to be eligible for trial. But, since then, nothing. No charges have been brought and no trial date set. Britain has made known its “strong reservations” about it all.

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The Washington sniper trial

In court at last

Oct 9th 2003 | VIRGINIA BEACH
From The Economist print edition

A struggle to hold a trial in the right place

SO SOON after Hurricane Isabel crashed ashore on September 18th, Virginia Beach is bracing itself for another storm, this one of media folk. On October 14th John Allen Muhammad goes on trial for his life in a Virginia court, accused of the shootings that terrorised the Washington area last autumn. Mr Muhammad and Lee Boyd Malvo, 18, are alleged to have killed ten people over three weeks in what is claimed to have been a scheme to extort $10m from the government.

AP

The vehicle of death

Though Mr Muhammad and Mr Malvo were charged with homicides in both Maryland and Virginia, law-enforcement officials—most notably John Ashcroft, the attorney-general—argued that they should be prosecuted in Virginia. That is because Virginia, a reliably Republican place in presidential years, has a stern record in capital murder cases, running second in executions only to President George Bush's home state of Texas. Virginia law also allows the execution of people for crimes they commit as minors. That would be the case with Mr Malvo, who, though legally an adult now, was 17 at the time of the killings.

Mr Muhammad's trial for the fatal shooting of a man outside a petrol station was moved about 200 miles to Virginia Beach from Prince William County, in Washington's northern Virginia suburbs, because a judge ruled that press coverage during the shootings had dashed any chance of assembling an impartial jury. Mr Malvo too—charged with the killing of an FBI analyst outside a home-improvement store—has had his trial moved. He was originally charged in Fairfax County, another bedroom community on the south bank of the Potomac river; but he will go on trial on November 10th in Chesapeake, a city carved from farmland and hemmed in by the Great Dismal Swamp.

Officials in both Virginia Beach and Chesapeake are on edge. With the likelihood of overlapping trials, they are anxious about the cost of security and disruption to other court business. But the two cities may be well suited for their new role. Both have brand-new courthouses with high-tech security systems and closed-circuit television to accommodate the press throng. The cities' demographics, however, are also relevant, since both defendants are black.

Virginia Beach, where Mr Muhammad's case will be heard, is not unlike Prince William County, though the resort is much larger. Both places have roughly the same racial make-up: 70% white, 20% black. And both are tough on law and order. But Chesapeake, the site of Mr Malvo's trial, is nearly 30% black, compared with just under 9% in Fairfax. That may count as a victory, of sorts, for the accused and his lawyers.

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Lexington

Flower power, three decades late

Oct 9th 2003
From The Economist print edition

With Arnie's victory, some Republicans have at last acknowledged America's cultural revolution

IN 1966, Californians elected a Hollywood actor as governor of their state. Fourteen years later, he changed America as the country's 40th president and the embodiment of a conservative revolution. Is history repeating itself? Perhaps as farce?

It is easy to count the reasons why Arnold Schwarzenegger's victory may be a special case, without wider significance. He won partly because of his exceptional celebrity, and partly because the recalled governor, Gray Davis, had all the popularity of a cat at a dog show. That circumstance may not repeat itself very often. He won as an outsider in a state that is peculiar anyway, in an election that was more than peculiar, when voters were uncommonly angry with elected officials.

Yet the fact remains that Mr Schwarzenegger has instantly become the second-best-known Republican in the country. He has become governor of a state with 55 Electoral College votes—a state, moreover, that many Republicans had almost written off (Al Gore won California by 1.3m votes in 2000, and 44% of Californian voters now register as Democrats, compared with 35% as Republicans). He brought a disaffected cohort of voters into the electoral process and into his party. Republicans would be foolish to write this off as merely another weird consequence of Californian voters spending too much time in the sun.

The key to the wider meaning of Mr Schwarzenegger's victory lies partly in his policies—much more liberal than those of most Republicans—and even more in the kind of person he is, including the sexual accusations that surfaced in the last days of the campaign. He is the first nationwide political figure to have embraced the counter-culture of the 1960s and 1970s (in its weaknesses as well as its strengths) and still stayed a Republican.

America was not unusual in experiencing the hedonistic, anti-authority, free-wheeling, drug-taking, free-sex counter-culture. Indeed, California was the epicentre of a worldwide movement. People went to San Francisco and wore flowers in their hair; others flocked to the southern beaches, Arnie's turf, for surf, self-indulgence and body-building.

But America was extremely unusual in experiencing a strong backlash against that revolution. Large parts of the country explicitly rejected almost everything it stood for. The counter-culture was pleasure-

seeking, socially liberal and predominantly urban. The backlash was censorious, strict in its views on the family and personal morality, and predominantly suburban. The counter-culture was rooted in opposition to the Vietnam war. The backlash was strongly patriotic. The counter-culture was secular, or bound up in New Age spirituality. The backlash was especially strong among born-again Christians. This time, California was not the epicentre: the south was.

In America, Republicans became the party of the backlash. They won their most stalwart supporters among southern conservatives. They opposed abortion and homosexual marriage. They led the great set-piece battle of the culture war, the impeachment of Bill Clinton, partly for louche sexual behaviour.

Mr Schwarzenegger is the antithesis of censorious Republicanism. He supports gay rights, gun laws, environmental regulation and affirmative action. Even the charges of sexual impropriety against him were curiously reminiscent of the Clinton scandals (though it has to be said that such behaviour is hardly the preserve of the counter-culture). In his personal behaviour, as well as his policies, he represents a different kind of Republicanism.

That behaviour, of course, has political drawbacks. Further revelations of personal misconduct could poison his governorship. But it has advantages, too. If his uncensoriousness suits hedonistic California particularly well, it also seems to chime with changes in American opinion more generally. Over the past decade, Americans as a whole have become socially more tolerant, with declining disapproval of homosexuality, inter-racial dating and people with HIV or AIDS. In this respect, the Republican Party has been swimming against the tide, despite its successes at the polls.

Come back, Barry Goldwater

But will such trends in popular opinion—and Mr Schwarzenegger's embodiment of them—make much difference politically? In 2000, Mr Bush also ran as a different, more inclusive Republican; but he has not governed that way. The gap between Republican and Democratic approval of his performance is wider than any previous president has known.

The problem is that America has an electoral system which exaggerates the importance of way-out opinion. Politicians control the drawing of district boundaries and frequently use that power to map out safe constituencies for themselves. California is an extreme instance. In the last redrawing of district boundaries, all but one of the state's 53 districts were in effect secured for the incumbent.

With their seats gerrymandered, elected politicians understandably align themselves more with the partisan views of activists (who have the power to propose another candidate for their seat) than with the moderate voters who actually elect them into office. It takes either an unusual figure or unusual circumstances to cut through this incumbency-protection racket. Mr Schwarzenegger and the recall election provided both.

That said, the elected governor is a reminder that there is a strand of Republicanism which was always more in tune with the counter-culture than the Bible-thumping variety that has dominated the party for the past decade. This is the libertarian wing associated with Barry Goldwater, another western Republican. In some ways, Mr Schwarzenegger represents a return to that tradition. His victory could begin a contest, against the current dominance of southern conservatism, for the party's soul.

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Venezuela's president

If you can't beat them, buy them

Oct 9th 2003 | CARACAS
From The Economist print edition

Hugo Chávez is clinging to power by every means at his disposal

Get article background

THE efforts of Venezuela's faction-ridden opposition to bring down President Hugo Chávez, the country's maverick leader, have tended to backfire: his poll ratings rose slightly after an attempted coup last year, and picked up again after a two-month strike designed to force him into an early election. That pattern may be about to change. A California-style referendum on whether to recall Mr Chávez as president now looks possible, perhaps in February or March 2004. Since, according to one recent survey, 73% of the electorate think that the country is in a “bad” or “very bad” state, the president has his work cut out to avoid being thrown out of office. He has begun it in earnest.

Mr Chávez was elected in 1998, promising to reduce poverty and end corruption, both of which have worsened under his rule. He was fiscally prudent in his first year; but then, in 2000, he was re-elected under a new constitution, which lengthened his presidential term to six years and made another Chávez term possible. The president's innate populist streak, with its attendant fiscal sloppiness, began to assert itself, aided by his control of all state institutions, including the emasculated government auditor.

Now, in campaign mode, he has cast off all remaining restraint. In one recent, six-week period, according to Datanalisis, a survey company, Mr Chávez committed the government to fresh programmes amounting to almost $1 billion of new spending (at the wildly optimistic official exchange rate). Among other things, he has launched ambitious literacy and health campaigns; promised university education to all high-school graduates; and announced the creation of a state airline and a new state-owned television channel. He also says he can conjure up half a million jobs by the end of the year.

Unfortunately, as Omar Bello, former vice-president of the central bank, puts it, “the [president's] political needs exceed the financial capacities of the state”—even though, after defeating the strikers, Mr Chávez took full control of the state oil corporation, Petróleos de Venezuela (PDVSA), the country's main cash-cow. The likely effect of this spending spree on an economy set to shrink this year by 13-15% is not hard to guess. Domestic government debt, subject to punishingly high interest rates, rose from 12,300 billion bolivars ($9.3billion) in December 2002, to 21,000 billion last month, not including around 6,000 billion bolivars in short-term central-bank borrowing. Orlando Ochoa, an economist, estimates that the government's borrowing requirement could top 10% of GDP next year, though the government itself has

made rosy forecasts for oil production and growth. The economic prospects for any alternative administration are grim.

But the president is offering more than just pork. The five members of a new electoral authority, who would organise and oversee any referendum, were appointed by Venezuela's supreme court in August. The opposition was initially pleased with the authority's composition, but its chairman has turned out to be less neutral than he seemed. There is plenty of scope for the authority to derail the referendum. Before one is held, its advocates must first persuade at least 2.4m people to sign a petition calling for a vote. The electoral authority has already rejected one attempt at a recall petition last month, on the basis of a technicality. Combined with the government's own machinations, it could make the target hard to reach.

The joys of democracy

Mr Chávez has also been doing his best to shake his opponents' composure, and thus take their dispute back on to the streets, rather than settling it in the polling booth. The national guard has used excessive force in ejecting sacked PDVSA employees from company housing. Globovision, a pro-opposition television news channel, had its microwave transmission equipment confiscated in punishment for an alleged technical offence, hobbling its operations. “It's important that the Venezuelan government explains the legal basis for that decision, otherwise there'll be some doubt about its commitment to respecting freedom of expression,” says Roger Noriega, the American State Department's top official for Latin America, politely. The president has been even ruder about his opponents than usual. And, presumably in a bid to secure the nationalist vote, he has repeatedly accused the United States, Colombia and the Dominican Republic of interfering in Venezuela's domestic affairs.

There is also some uncorroborated speculation that the government may be behind a series of mysterious bombings at heavily guarded, mainly military installations, which have so far caused no injuries. The theory is that Mr Chávez stands to gain the most if the current election fever should turn violent, though there may be other explanations, such as unrest in the armed forces. Earlier this month, Mr Chávez announced (again) that he would be putting the national guard and military police on to Venezuela's streets, ostensibly to supplement an ineffectual police force struggling with a crime wave. But a reference to Globovision bosses as “criminals” in the same broadcast suggested that he had other threats on his mind.

How desperate is the president? As they have done for the past two years, his opponents predict that he will declare a state of emergency. The diplomatic costs for Mr Chávez of so doing probably mean that they are wrong this time, too. Yet the stakes are high. If more than 3.75m people were to sign the referendum petition—the number of votes that will be required under Venezuela's constitution to oust Mr Chávez if the referendum is held—his days in power would be numbered. Mr Chávez must avoid such an expression of discontent at all costs.

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Peru's government

Spying on the spies

Oct 9th 2003 | LIMA
From The Economist print edition

Wanted: an intelligence service worth the name

Reuters

Montesinos, master of the dark arts

THROUGHOUT the 1990s, Peru's National Intelligence Service was synonymous with Vladimiro Montesinos, the sinister spy chief who spun a web of corruption and intimidation from the heart of the authoritarian government of Alberto Fujimori. Since July 2001, Peru has been governed democratically under President Alejandro Toledo, and Mr Montesinos is now in jail. But the intelligence service remains in turmoil—just when once again Peru needs one.

Last month, Mr Toledo sacked the service's head, Alfonso Panizo, a retired admiral, the fourth man to hold the job in two years. His departure came after it had emerged that one of the president's phone calls had been tapped, and the tape of the call given to a scandal-hungry television programme. Another television show then accused the intelligence service of spying on several awkward journalists. Mr Panizo denied the charges; his agents were simply trying to discover who was leaking secrets to the media, he said.

The new intelligence chief is Daniel Mora, a retired general but also a member of Mr Toledo's Perú Posible party (its secretary for ethics, no less). His appointment has stirred controversy: opponents say that the intelligence service should serve the state, rather than the governing party. But the bigger problem is that the service needs thorough reform.

Mr Montesinos still casts a long shadow. He turned the service from a small group of academics and analysts into a lavish outfit packed with military men engaged in dirty tricks. Sophisticated monitoring equipment, some donated by America's Central Intelligence Agency to fight drugs, was diverted to political and commercial use. Mr Montesinos routinely tapped the phones of politicians, journalists, top businessmen and judges; he even surreptitiously recorded some of Mr Fujimori's private meetings.

Mr Toledo's government has slashed the service's budget and personnel (though it is still overstaffed). The perverse result is that most of the monitoring equipment now seems to be in the hands of private security companies, some run by former army cronies of Mr Montesinos. In effect, telephone-tapping has been privatised; the results are leaked to pursue political vendettas.

Apart from poisoning politics, all this is bad for public safety. Peru has real security threats that need watching. Drug exports are rising, as is kidnapping. Though nothing like the threat they used to be, small groups of Shining Path guerrillas roam remote areas. The country needs spies—but honest ones.

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Jamaica

Brain gain

Oct 9th 2003 | KINGSTON
From The Economist print edition

Bright Jamaicans are going home, which is good news for their country

LIKE many of her contemporaries, Eleanor Brown left Jamaica to be educated and work abroad. But unlike emigrants of previous generations—such as the family of Colin Powell, America's secretary of state—Ms Brown came home. At 31, she is now managing director of her own financial-services company, and is on the board of five others. She is a good example of a growing trend, one which is already having an important economic and political impact across the Caribbean, and especially in Jamaica: the returning “yuppie”, making good in the land of her birth.

When Ms Brown left Jamaica, she became part of the island's diaspora of 2m-3m people—huge for a country with a population of just 2.6m. Many left because of the crime and instability that have blighted Jamaica over the past 30 years. Like many other emigrants, Ms Brown, who holds degrees from Brown, Yale and Oxford universities, was among the cream of the nation's talent. This brain-drain is one of the main reasons why Jamaica has struggled in recent decades.

Why are these young professionals returning now? Partly because of a modest recovery in the island's fortunes, particularly since the financial system collapsed in the mid-1990s. The downturn in America has also helped to narrow the gap in opportunities between New York or Miami and the Caribbean. Then there is a perception that returning exiles can assume higher levels of responsibility at home, and at a much younger age, than they could in Britain or America. Ms Brown thinks that she would have waited “another 20 years” for the openings that have come her way in Jamaica. Likewise, Kristine Gibbon, who left Trinidad to be educated at Harvard Business School and elsewhere, says that she can make a bigger difference in her small native country. At 32, she is a vice-president at one of the largest regional financial companies.

Some of those who come back find they have lived for too long in the first world to cope with the power failures, bad roads, poor health-care and often conservative ways of the Caribbean. Jason Reid, for example, fled again to Wall Street after just a year in Jamaica, citing the “parochial attitude” of the region and an “unwillingness to embrace change”. To sweeten the pill, some governments have for years run schemes to entice exiles back. But it is often the private sector that has taken the lead, vigorously recruiting on Wall Street.

The exiles themselves have done their bit too: noting the high proportion of Caribbean-born students at America's top business schools, a group of them last year founded a network to connect this talent pool more closely with the islands. Such high-flyers can help even if they remain abroad, as the examples of other countries that have raised cash through “diaspora bonds” attest. Aubyn Hill, a former exile who now runs the National Commercial Bank, one of Jamaica's largest private banks, is trying to arrange a similar bond issue to restore a part of central Kingston, the capital. This is the kind of “business savvy” that Phillip Paulwell, Jamaica's minister for commerce and technology, is talking about when he describes the “tremendous impact” that the homecomers have had on sectors such as banking, business and telecommunications.

But it is in politics that their presence may yet be most keenly felt. This could be the generation that finally replaces the dinosaurs who have run Jamaica's two main parties for the past three decades. Deika Morrison, for instance, was lured back by the ruling party last year to become a junior minister of finance, while doing her fourth degree in the United States. At 30, she is the most prominent of many former exiles who are quietly transforming Jamaica's politics.

Ms Morrison says one of her main advantages is that she “does not have a history”, and so can transcend the often sterile, partisan pettiness that is one reason why turnout at Jamaican general elections has

steadily declined. She sees herself as a “practical problem-solver”—a useful person in a place with plenty of problems.

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Ontario's election

A new order

Oct 9th 2003 | OTTAWA
From The Economist print edition

After their triumph in Ontario, the Liberals are rampant

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WHEN Ontario's Liberals secured a landslide victory in the provincial election of October 2nd, they also produced a political situation that Canada has not seen for 60 years. Given that the Quebec Liberals routed the separatists in their election in April, Liberals now control the two largest provinces, which together account for about two-thirds of the country's total population, economy and trade. Meanwhile, the federal Liberals this month mark a decade in power in Ottawa under Jean Chrétien, and are set to win a fourth successive election under Paul Martin's leadership next year. Canada is looking increasingly like a one-party state.

Reuters

Lock up your kittens, here comes McGuinty

In the past, Canadian voters have maintained a political balance by electing different parties at provincial and federal levels. Except for 17 Tory years, the Liberals have run the federal government since 1935, while the Progressive Conservatives have ruled Ontario for all but ten years of the past 60. Voters have sometimes contrived to spread power still more evenly by electing minority administrations at both levels. Last week the exaggerations of the first-past-the-post system gave Ontario's Liberals, led by Dalton McGuinty, a huge majority—72 of the 103 seats, with only 46% of the vote—while the Conservatives and New Democrats, who between them won half the popular vote, got just 31.

The erstwhile power balance had its downside, which may partly explain why Ontario voted as it did. Relations between Ottawa and the provinces are often fractious, with each blaming the other for unforeseen problems, such as this year's SARS outbreak. Doubtless the provincial premiers will still complain about the control Ottawa exercises over taxation, and the reduced funds that it has distributed for education and welfare services since 1994 (when Mr Martin, as finance minister, began eliminating the federal budget deficit). But Mr Martin—a shoo-in to take over as prime minister in February—has arranged an informal and unusual meeting with all the provincial premiers on November 16th. Meanwhile, Jean Charest, leader of the Quebec Liberals, is gathering the premiers on October 23rd at a meeting of the Council of the Federation, the body he has conceived to present the case for a more stable (and better-financed) relationship with Ottawa.

To his credit—and, it seems, to his benefit—Mr McGuinty ran a high-minded campaign, ignoring the personal attacks that Ernie Eves, the normally courteous outgoing Conservative premier, allowed his backroom staff to launch. Among other slurs, they alleged that Mr McGuinty was “a kitten-eating alien”.

But while clean, Mr McGuinty's campaign could prove expensive, and he will welcome any help his fellow premiers can offer as he sets about winkling money out of Ottawa to meet his election promises. His costly platform included pledges to keep class sizes for young pupils to a maximum of 20 students, which will require more teachers and classrooms, and to hire 8,000 nurses to help revive the health service.

Still, Mr McGuinty's chances of meeting his pledges may be enhanced by Canada's new political geometry. He campaigned heavily in the suburban areas around Toronto, which in two previous elections had helped to return the Conservatives. Mr McGuinty won over many of these voters by professing a deep concern about the state of urban services. Happily for him, Mr Martin has voiced similar concerns. Equally helpfully, he represents the constituency that sends John Manley, the federal finance minister, to Ottawa. Canada may now be a one-party state, at least in parts, but Liberal hegemony may have some advantages.

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North Korea

Progress at a snail's pace

Oct 9th 2003
From The Economist print edition

Magnum Photos

Economic reforms launched over a year ago have born only small fruit

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FOR a country as cautious as North Korea, a lot has changed since a series of economic reforms were announced 15 months ago. One source, an aid worker who recently spent more than a month travelling around the North, noticed many small developments. The electricity supply, for instance, has slightly improved in the capital city, Pyongyang, as well as on the east coast in Hamhung and Chongjin. Apartment-block lights are now on for much longer. Second-hand bicycles, from Japan and China, are numerous, particularly in cities on the poor, industrial east coast. Farmers are allowed their own small gardens, and farmers' markets are now referred to simply as “markets”, because, as well as food, they sell consumer goods.

Significantly, these markets have been given official approval. In fact, in June—despite its nuclear troubles with the outside world—the government appealed for help from other countries in running them. As Marcus Noland of the Institute for International Economics in Washington, DC, explains, one immediate effect of the reforms is that there are now products available for hard currency, such as video players and movies like “The Lion King” dubbed in Korean, which were previously unobtainable. The government is also encouraging foreign investment in industries such as mining, energy, agriculture and information technology. And in an unprecedented move, the leadership recently gave its approval for a South Korean company that assembles cars in North Korea to launch a marketing campaign there.

North Korea's leader, Kim Jong Il, also has a penchant for all things high-tech. Mobile-phone services have been started in the country's main cities and along its motorways. North Korea's tourism authority claims that 2,000 Motorola and Nokia mobile handphones were sold in Pyongyang between November 2002 and August 2003. This in a country where barely a million land lines exist, out of a total population of 23m.

The Hermit Kingdom recently announced plans to develop broadband internet capabilities to improve the business environment. The plan is to link the domestic intranet, called Kwangmyong, to the internet. The North's national domain designation, “.kp”, is still not in use, but the government has reportedly been testing e-mail addresses incorporating it. There is even an internet café in Pyongyang, though at $10 per hour it is affordable only to the few tourists, diplomats and journalists who visit the city. Currently, only Mr Kim and a few privileged others can use the optical communications lines supplied to North Korea by China's China Telecom. Contrast this to the state of affairs in the south, which has the world's greatest

penetration of high-speed broadband connections and where more than 65% of households now have internet access.

The evidence, although anecdotal, suggests that the North is really trying to change. But these observations say little about how the economy as a whole is doing. The sad truth seems to be that the leadership in the North undertook its partial reforms out of necessity, not because it had understood or embraced the market. Rather, for the past 15 months, according to a Korea expert, Kongdan Oh, at the Institute for Defence Analyses in Virginia, the country has been “creatively muddling through”. While the average North Korean has more economic freedom, the economy is near collapse.

Remove the rose-tinted glasses

Nicholas Eberstadt of the American Enterprise Institute, in Washington, DC, estimates that, if anything, economic decline has accelerated, not reversed. Last year's price and wage increases saw prices rise 10 to 20-fold and wages rise by 20 times or more, the idea being to bring them more into line with market rates. But the increases have not been matched by measures to boost output, so inflation has spiralled out of control. The price of staple foods, for instance, has risen by as much as 400%, and the country continues to rely on foreign handouts to feed its people.

In a recent paper, Mr Noland argues that those with access to foreign exchange, such as senior party officials, do not feel the effects of inflation as severely as salaried workers who have no access to foreign exchange. So for urban residents with access to hard currency, in some respects things are much better. But for the bulk of the population, things are quite grim. As much as 80% of an average family's income now goes towards food.

Just how committed is the regime of Kim Jong Il to its programme of market reform? Probably not very. It shows no sign of embracing reforms that could potentially undermine the state's control. It continues to emphasise “military-first” policies, reserving the best of everything for the army it depends on. And even if greater economic reform were undertaken, it is far from certain that it would be successful any time soon.

The economy continues to suffer from a lack of energy, transport infrastructure and basic foodstuffs. Many factories—all of which under the reforms now have to pay their own way—have been shut down, leaving people without jobs and therefore no money to buy food. And since the North admitted last year to its illicit nuclear programme, aid flows have diminished and oil deliveries by the Korean Peninsula Energy Development Organisation have been suspended.

Foreign investors still stay away and the few companies that have been bold enough to invest in the North, such as Hyundai Asan, have lost millions of dollars. So, though much has changed in North Korea over the past 15 months, the probability is that more will stay the same.

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Japan, South Korea and Iraq

Helping hands

Oct 9th 2003 | TOKYO
From The Economist print edition

Japan and South Korea debate helping George Bush in Iraq

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ONE Asian leader sees an opportunity, the other a dilemma. Junichiro Koizumi, Japan's prime minister, views America's plea to send troops to Iraq as a chance to stretch the limits that have long constrained Japan's defence policy. By contrast, the biggest foreign-policy challenge facing Roh Moo-hyun, South Korea's president, is responding to North Korea's nuclear threats and the anti-Americanism that George Bush's firm response has exacerbated in the South. Mr Roh has tried to avoid choosing sides. Now, however, the Iraq question threatens to force his hand.

It is not hard to guess, therefore, which leader Mr Bush intends to visit on his way to a Bangkok summit of Asia-Pacific countries. On October 17th, Mr Bush is planning to stop overnight in Tokyo, refuel his plane, and have dinner with Mr Koizumi. Although Mr Koizumi plans to send members of Japan's "self-defence forces" to help stabilise Iraq, he may not be able to give Mr Bush any news about the timing of their deployment. The prime minister will want to delay sending troops until after the general election on November 9th.

Although he will have to wait for troops, however, Mr Bush should soon receive a more traditional Japanese foreign-policy gift: money. The foreign ministry's experienced artisans have been haggling with the finance ministry over how much aid—America has asked for "several billion dollars"—to carve out for Iraq between 2004 and 2007. They hope to have the package neatly wrapped by the time Mr Bush arrives, or, failing that, in time for a donors' meeting on Iraq's reconstruction the following week in Madrid.

Mr Koizumi will probably also have good news on another security front. Last week, the lower house of parliament approved a two-year extension, beginning on November 1st, of the anti-terrorism bill that Japan enacted after the September 2001 attacks on America. The upper house was expected to approve the extension on October 10th. The law, which allows Japanese ships to refuel and supply allied ships for security operations in and around Afghanistan, slipped through a loophole in Japan's pacifist constitution.

Such self-imposed constitutional constraints are not an issue for South Korea. Its 700,000-men armed forces are considered some of the world's tougher, and are often deployed abroad. Indeed, South Korea has already taken the step that Mr Koizumi is postponing until after the election, by sending 675 military engineers and medics to Iraq. But America has asked South Korea to do more and has requested several thousand combat troops. On October 7th, the speaker of the National Assembly suggested that Mr Roh should quickly assent.

Mr Roh, however, has been stalling, and not just because fierce domestic protests would accompany a decision to send troops. For the South Korean leader, the main consideration is negotiations with North Korea, towards which he would like Mr Bush to take a softer line. His government has explicitly linked the two issues, saying that he wants to see more progress on North Korea talks before agreeing to send troops to Iraq. The North Korean regime has gleefully weighed in, saying that it will become even more unco-operative if South Korea sends troops to Iraq.

Although this is not the response the White House was hoping for, publicly pressing Mr Roh is only likely to intensify anti-American protests in South Korea, making him even less likely to help. This week, Donald Rumsfeld, America's defence secretary, postponed a trip to South Korea and Japan that he had been planning for late October. It seems safer for Mr Rumsfeld to keep his distance.

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The Philippines

Surprise, surprise

Oct 9th 2003 | MANILA
From The Economist print edition

President Arroyo decides against retirement

FEW people were astonished when, on October 4th, President Gloria Macapagal Arroyo announced that she would postpone her retirement and contest the presidential election scheduled for next May. Mrs Arroyo's change of mind makes her the central figure in the election, and the future of the country's politics may now be a little less murky.

Last December, Mrs Arroyo had declared that she would retire when her current term ends. She explained that she wished to spend her remaining months as president concentrating on the country's problems, particularly poverty, rather than on campaigning. Many Filipinos were immediately sceptical. Her opponents considered it a ploy to deflect criticism of her administration. The sceptics turned out to be right, and Mrs Arroyo made her announcement at an official engagement in her home province of Pampanga that had all the appearances of a campaign rally.

The president said there had been a popular clamour for her to run and prodding from her own party. Opinion polls conducted before October 4th, however, indicated that popular desire for another Arroyo term was less than clamorous, especially since corruption allegations against her husband have surfaced. But her political party, Lakas, certainly lacks an alternative candidate with the potential to win the election.

Mrs Arroyo added that the main reason for her change of mind was that she had come to the conclusion she had the vision and experience to continue to govern. Her vision does entail fundamental political and economic reforms, though her plans are vague. As for experience, since she took office in 2001, her government has staggered from one crisis to another—the most recent being an army mutiny in July, which she has treated as an attempted coup d'état. The government has dealt gamely with all the crises, but they have left the president little time for reform.

Even so, Mrs Arroyo's on-the-job experience is unique. Candidates usually have none, since the constitution allows a president only one six-year term. Mrs Arroyo is permitted to run for election because she was previously vice-president, elevated to the top job not through the ballot box but after her predecessor, Joseph Estrada, had been accused of corruption and overthrown. The devil they know might appeal to the voters. And, uniquely, Mrs Arroyo will be able to use the public exposure that goes with being the incumbent to increase her appeal.

This makes her the one to beat. Before she announced her candidacy, only two others had stepped forward. One is a former education secretary, Raul Roco, who warned Mrs Arroyo against using government resources for her campaign. Mr Roco has a reputation for probity, but his manifesto is even woollier than the president's. The other candidate is a senator, Panfilo Lacson, who was chief of police under Mr Estrada. He has a reputation for getting results—so much so that he is being prosecuted for murdering criminal suspects, a charge he denies. Other possible candidates include a brewer, a film actor and a television news presenter.

All these contenders, definite or possible, are relatively unknown quantities. Mrs Arroyo's candidacy should, at least, force them to compare their own vision and experience with hers. That would give voters a clearer idea of what to expect from the next president and add a measure of predictability to the country's political and economic future.

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China

Desperate measures

Oct 9th 2003 | BEIJING
From The Economist print edition

Protests against forced relocation are getting worse

ATTEMPTING suicide by burning oneself in public is a particularly powerful form of protest in China, to which even the most desperate rarely resort. Yet in the past seven weeks, at least three people have tried to kill themselves in this way. Their grievances have been the same: forced relocation from their homes to make way for commercial developments. The extent of public anger over the brutality and unfairness involved in China's urban makeover is starting to alarm the leadership.

Reuters

Household removals, Beijing-style

This weekend, the Central Committee of China's Communist Party begins a meeting to set policy guidelines for the leaders who took office late last year and early this. The new party chief, Hu Jintao, presents himself as a man attuned to the sufferings of those pushed aside by China's breakneck development. Addressing the complaints of those whose shabby old homes are being demolished is hard.

The number of protests triggered by urban redevelopment has risen fast in recent years. According to the official *China Economic Times*, 8,516 petitions were delivered to the central government in 2001 complaining about forced relocation. The figure increased to 13,513 last year and already stood at 11,641 for the first eight months of this year. Frenzied investment in construction—up 33% between January and August compared with the same period a year ago—is fuelling the greed of developers and of officials who take bribes in return for development rights.

The protests have become more potent recently. On August 22nd, a man set fire to himself in the eastern city of Nanjing after his house was destroyed to make way for a new business district. On September 15th, a man did the same in Tiananmen Square, and another tried on September 25th in eastern Beijing.

China Daily, an official newspaper, noted that according to the law, the government cannot take away residents' land-use rights except for public-welfare projects. In practice, local officials often sell land-use rights without consulting the occupants of buildings on the land. Developers, with official connivance, sometimes intimidate occupants into accepting meagre compensation. The residents may get newer housing, but often far from their work.

Whether the government is likely to offer much more than sympathy is doubtful, given the massive development plans that Beijing, Shanghai and other cities have in mind. Beijing will hold the Olympic

Games in 2008 which will involve a lot of work for the demolition teams. Shanghai has been relocating people at a rate of 80,000 a year since 2000 and plans to move another 400,000 by 2007 (the city wants a new look for the 2010 World Fair).

In September, 152 lawyers in Shanghai formed a group to give legal aid to those being moved out. But other, unnamed lawyers have been quoted as saying that without laws clarifying the rights of the uprooted, talk of protecting their interests is “idle”. They might also have mentioned one Shanghai lawyer, Zheng Enchong, who argued on behalf of the displaced. He was arrested in June on what human-rights groups say are bogus charges.

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ASEAN

A holiday in Bali

Oct 9th 2003 | NUSA DUA
From The Economist print edition

Some fine words, but limited action

IN THE heart of Bali's main tourist strip at Kuta, workmen have spent the past week frantically sanding and cementing, in a scramble to finish a small memorial to the victims of last year's bombing in time for the first anniversary of the attack, on October 12th. A few kilometres away, in the holiday resort of Nusa Dua, South-East Asian leaders were busily doing some construction work of their own, on what they grandly refer to as the region's economic and security architecture.

This conjunction is no coincidence. ASEAN, South-East Asia's regional club, deliberately chose Bali as the site of its annual summit to show steadfastness in the face of terrorism and to promote the island's recovery. On a grander scale, the summit was supposed to demonstrate ASEAN's determination to overcome the security threats, economic doubts and institutional weaknesses that have dogged it of late. In the end, however, the locals showed more resolve than their guests.

Ordinary Balinese are full of defiance. Paddy's Bar, one of the nightspots destroyed in the bombing, has reopened a few hundred metres down the road. Kuta as a whole is holding a “celebration of life” in honour of the 202 people who died in the blast. Tourists are back, although not in the same numbers as before. Many worry that terrorists may try to disrupt the anniversary commemorations. But if security at the summit was anything to go by, the authorities were taking no chances. Soldiers, police and sniffer dogs lined the streets, and searched cars entering the sequestered Nusa Dua compound. The show of strength was so dramatic that hotels felt obliged to send their guests messages to say there was no cause for alarm.

Behind this defensive shield, the grandees of ASEAN proudly declared that they had taken firm steps to improve security throughout the region. China and India, which are not members of ASEAN but attended the summit as guests, both signed a Treaty of Amity and Co-operation, a sort of regional non-aggression pact. The ten ASEAN countries, meanwhile, deputed Indonesia to draw up a plan to bring security co-operation to a higher plane.

But the delegates followed that instruction with the immediate caveat that they were not aspiring to a defence pact, military alliance or joint foreign policy. In fact, in areas of obvious mutual concern, such as terrorism, ASEAN does seem to co-operate well. The problem is that there are few such areas—and they do not include the two designated for greater collaboration: smuggling and drug-trafficking. Myanmar, for one, is reluctant to stem the flow of drugs to Thailand. Singapore is accused of tolerating the import of contraband sand and logs from Indonesia. Earlier this year, Thailand scrambled its army along its border with Cambodia, while Malaysia and Singapore waxed histrionic over a minor border dispute.

China's promise at last year's summit to negotiate a free-trade zone with ASEAN within ten years has prompted some healthy competition. This year, both Japan and India made similar pledges. The ASEAN countries themselves adopted a sensible scheme to start monitoring one another's compliance with their free-trade pact by the end of next year, and to create a legally binding system to resolve disputes. They also agreed to flesh out earlier commitments to eliminate non-tariff barriers to trade, and to accelerate economic integration in 11 industries.

In other words, ASEAN's leaders could not actually agree to accelerate integration across the board, despite their much publicised intention to establish an Economic Community by 2020.

Thailand and Singapore urged the group to move faster, or at least to give its blessing to those members who wanted to do so—but the other members demurred. In fact, the exasperated pair have been pursuing their own initiatives for some time, despite their allies' misgivings. They are working on an open-skies agreement, for example, and are pursuing their own bilateral free-trade deals.

The summit papered over these differences with a show of camaraderie. Megawati Sukarnoputri, Indonesia's president, wept as she paid tribute to Mahathir Mohamad, Malaysia's outgoing prime minister. ASEAN also rallied around Myanmar, despite its failure to keep a promise to move towards democracy. Indeed, ASEAN's leaders seem positively proud of their organisation's ability to accommodate dictators, democrats, capitalists and communists. No wonder, then, that they have trouble agreeing on anything.

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Kazakhstan

Caspian, ho!

Oct 9th 2003
From The Economist print edition

Kazakhstan's naval ambitions

OF ALL the regions in the world, Central Asia is the farthest from the ocean. One of its few bodies of water, the Aral sea, is running dry. But Kazakhstan's decision earlier this year to create a full-fledged navy is far from an eccentric whim. Most of Kazakhstan's oil wealth lies around and in the Caspian sea, which also borders Iran, Russia, Azerbaijan and Turkmenistan. The country's authorities say they want to protect western investments and keep smuggling and other shady activities in check.

Kazakhstan's decision adds to the increasing militarisation of the Caspian area. Russia has beefed up its naval presence, and Turkmenistan and Azerbaijan are trying to modernise their fleets. According to Frederick Starr, head of the Washington-based Central Asia-Caucasus Institute, “for Kazakhstan to sit passively would be to hand over an important piece of what it sees as its sovereignty, namely the ability to protect its own borders.”

Kazakhstan says the decision is not directed at other Caspian states. Yet there is a continuing dispute over the delineation of national borders within the sea—with big implications for its oilfields. In 2001, an Iranian gunship ordered research vessels from Azerbaijan to retreat from a disputed oilfield. According to Robert McMullin of the Centre for Strategic and International Studies, also in Washington, DC, establishing a better balance of power in the Caspian may help promote stability. Fuzzy borders could make the operation of the navy tricky—although at least Kazakhstan and Russia agreed on a dividing line last year. The shallow waters of the north Caspian, frozen for part of the year, will not make operations easier.

The government estimates it will take seven to ten years for the navy to be fully operational. Russia, Turkey and the United States, which has just sealed a five-year military agreement with Kazakhstan, have all promised to help.

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The Middle East conflict

Israeli frustration versus Syrian impotence

Oct 9th 2003 | CAIRO AND JERUSALEM
From The Economist print edition

AP

Why Israel, led by Ariel Sharon (above), reacted to a Palestinian suicide bomb by hitting Syria for the first time in 30 years, stoking fears of a wider Middle East war

Get article background

CONSIDERING the current volume of Middle East violence, the blowing up of an empty shed in a remote ravine should sound like faint background noise. But, unlike the Palestinian suicide bomb that killed at least 19 diners at an Israeli restaurant in Haifa on October 4th, the apparently harmless demolition that came a few hours later was new and different. The shed was part of an old training camp for Palestinian guerrillas at Ain Saheb that happens to be near the Syrian capital, Damascus. The airstrike that flattened it was Israel's first direct attack on its northern neighbour since the war of 1973.

Among the victims of the Haifa outrage were two families of five—grandparents, parents and children. Four of the dead were Israeli Arabs. The seafront restaurant, Maxim's, is jointly owned by Jews and Arabs. The killer, a 29-year-old woman lawyer from Jenin in the West Bank, was apparently avenging the deaths of a brother and cousin, killed four months ago by Israeli troops hunting Islamic Jihad. She changed from her *jalabiya* into a shirt and jeans, apparently slipping through a gate in Israel's vaunted security barrier (see article) and then into the restaurant.

In any event, Israel's message of retaliation echoed loud and clear. Not only was it a signal that Syria may now be punished for the cover it has long given to extremist factions such as Islamic Jihad, from whom the Israelis say they picked up a message in Damascus congratulating its cell in Jenin for the attack. Israel also showed it can hit deep inside Syria, and with seeming impunity. In short, the message was that Israel is strong and Syria weak—and that the rules of the game have changed.

It is not a comfortable message for Syria's rulers, who admit that they harbour militants out of sympathy for the Palestinian cause but insist that they have no operational control over the *intifada*, the Palestinian uprising in the Israeli-occupied territories that began three years ago. Neither is the message welcome to a wider Arab public increasingly distressed by its leaders' obvious impotence. But it also disturbs many Israelis, who fear that by widening the sphere of conflict beyond Israel's borders, their own leaders risk starting an even greater cycle of violence. Such fears were heightened by the fact that Israel's attack fell on the 30th anniversary of the 1973 war, which both sides claim as a victory even as they still nurse its old wounds.

An exchange of fire on the Lebanese border the next day, killing a Lebanese boy and an Israeli soldier, did nothing to soothe worries. Nor did the subsequent stark warnings by the Israeli government of future action, backed by a map sent to journalists that purports to pinpoint “Palestinian terror networks” in Damascus.

On the Arab side, at least, the fears were compounded by the Americans' reaction. Rather than condemn Israel's strike, as virtually everyone else did, the Bush administration endorsed its ally's right to self-defence and called for restraint on all sides. But by implying that Israel's action represented an extension of its own war on terror, the Americans seemed to be warning Baathist Syria that it could face the same fate as Saddam Hussein's Iraq. Congress, meanwhile, was poised to pass a bill punishing Syria for its supposed support for terror and alleged pursuit of banned weapons technologies. That would further isolate Syria but also reinforce the impression that America is bent on bullying Arab governments into submission.

The worries about a wider war may be exaggerated, at least for the time being. Syria's rusting, Soviet-era army is in no state to retaliate in kind. Resort to its only real deterrent, an arsenal of Scud missiles, would invite a crushing Israeli counterstrike. In the past, Syria has responded by proxy, mainly with pinprick attacks by its Lebanese militia ally, Hizbullah, across Israel's northern border. But this option is also limited, as most Lebanese object to seeing their battered country exposed again to Israeli target practice.

For its part, Israel is likely to pause before raising the stakes. While long considered, and not unexpected, its decision to bash Syria appears to have been partly a recognition that other measures to stamp out the *intifada*, such as assassinations and blockades, have proved ineffective. Israel's policy of avenging any attack on its citizens dictated a dramatic response to the restaurant bombing, and other options, such as targeting the Palestinian leader, Yasser Arafat, seemed inappropriate. And though Israel has taken advantage of America's presence in Iraq to strike its old enemy, it would rather avoid stirring Arab passions to the point that they spell more danger for America's occupying forces.

Besides, Israel will want to see if its new tactic works and the Syrians move to meet its demands, namely by shutting down militant groups' offices, expelling their leaders, withdrawing forces from Lebanon and disarming Hizbullah. The trouble is that by hitting Syria, Israel has made it politically even trickier for the government in Damascus to oblige.

Even before the Israeli strike, the Syrian regime was in a parlous state. Its army has scarcely re-equipped since the 1970s, and its stabs at reform have failed to stir either economic growth or political liberalisation. Syria's self-proclaimed role as the vanguard of Arab nationalism has lost its lustre, given the fracturing of Arab alliances and America's intrusion into the area. President Bashar Assad appeared to promise sweeping changes when he inherited power from his father three years ago but has delivered little more than long speeches lauding the glory of “Arab resistance”. A much heralded cabinet reshuffle last month produced a familiar cast of grey apparatchiks.

In effect, the country's old guard appears to be responding to pressure by retrenching, armadillo-like, behind old slogans. That is not to say that Syria has been blind to its predicament. In the wake of September 11th, its government hastened to curry favour with the Americans by providing extensive intelligence on Islamist groups deemed to be terrorist. After the invasion of Iraq, Syria responded to accusations that it had allowed foreign resistance fighters into Iraq by sealing its border and handing over fugitive Iraqi officials. It also met American demands in May by formally closing the Damascus

offices of Islamic Jihad, Hamas and other Palestinian militant factions.

But these groups have maintained “political bureaus” under Syrian protection in Lebanon's capital, Beirut, as well—claim the Israelis—as training facilities in Syria. Mr Assad now vows to stand firm. “We have completely rejected the expulsion demands,” he said this week. “These people did not break Syrian law and did not hurt Syrian interests—and they are, above all, not terrorists.” Debatable points; but what is beyond debate is that Mr Assad himself is in a pickle.

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Iraqi business

Jobs for the boys—and for foreigners

Oct 9th 2003 | BAGHDAD
From The Economist print edition

Iraqis are worried that outsiders are getting too many jobs

Get article background

EPA

Burning for a job

AT THE back of Baghdad airport, now an American military base, Iraqi day-labourers clamour for the construction and service jobs that thousands of imported Indian and Bangladeshi workers are doing inside the perimeter. Iraqis are a security risk, say American soldiers; more and more Iraqis who come looking for work are being rejected—and turned into disgruntled protesters.

The first demonstrations outside the gates of the Coalition Provisional Authority (CPA, in effect, Iraq's American-run government) were small. But over the past fortnight, the number of protesters has swelled from less than a hundred to several thousand. On October 4th, American troops opened fire, in the biggest clashes with Iraqis since Baghdad's fall in April. Rallies spread to other cities, from Kirkuk in the north to Basra in the south, where British troops fired rubber bullets.

The main spark for the riots was Iraqi bitterness over redundancy pay for soldiers who lost their jobs when Paul Bremer, the American boss of the CPA, disbanded Iraq's 750,000-strong armed forces. Soldiers, some in wheelchairs, queue for dole from dawn to dusk—a humiliation, say former Iraqi officers. “Would Americans tolerate such treatment of their war veterans?” fumes an Iraqi former general.

The mass import of migrants to service the American-led armies further fuels resentment. Saudi caterers contracted by Kellogg Brown and Root, a subsidiary of Halliburton, an American oil-services company, have shipped in hundreds of Indian and Bangladeshi cooks to avoid, they say, the risk that Iraqis might poison the food. Filipina maids hired in Jordan do the cleaning. Lorries from the Gulf states bring in thousands of tonnes of provisions every day because Iraqi food does not meet American specifications. No-entry signs at the back of the coalition's Baghdad headquarters are in Urdu and Bengali, not Arabic.

To cap it all, a new investment law lets foreign contractors bring in labour from abroad but export all profits. Those Iraqis who do get contracts are often just back from exile. A recent tender for a mobile-phone franchise for southern Iraq was won by a consortium led by the son of the media director for Ahmed Chalabi's Iraqi National Congress, who had just returned from Canada. And Iraqis fret at the lack of auditors and openness in Iraq's Governing Council and over the UN's Development Fund for Iraq, where Iraq's oil revenues are supposed to go. “Are we no better than Saddam's sons?”, asks an Iraqi recently back from abroad, noting the growing links between politicians and businessmen.

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Turkey and the Kurds

Pragmatism prevails, so far

Oct 9th 2003 | ANKARA AND ARBIL
From The Economist print edition

Most of the Kurdish groups in Iraq will, glumly, accept Turks—in transit

IN HIS biggest gamble since taking over as Turkey's prime minister seven months ago, Tayyip Erdogan this week persuaded an overwhelming majority of MPs from his ruling Justice and Development Party to let his government send as many as 10,000 Turkish soldiers to Iraq for a year. Many Turks are still queasy about the idea. Not surprisingly, even more Kurds, on both sides of the Turkish-Iraqi border, are unhappy too. But there is a fair chance, provided the Turkish troops do not linger near the border or set up permanent supply posts on their way south, that the operation will proceed smoothly.

Mr Erdogan had two reasons for striving so hard to win the vote in parliament. First, he wanted to get back into the good books of his country's chief ally and benefactor, the United States; a loan of $8.5 billion is in the offing. The Americans had been enraged, last March, when Turkey's parliament refused to let some 60,000 American troops use Turkey as a launch-pad for invading Iraq from the north.

AP

The younger Ocalan, sitting tight

Second, Mr Erdogan wants to promote Turkey as a big player in Iraq—and in the Middle East as a whole. In particular, he wants to help deter Iraq's Kurds from edging towards the establishment of an independent homeland that would foster separatist yearnings among Turkey's own 14m or so Kurds.

Unsurprisingly, Iraq's Kurds are not so happy. Many say they are still loth to let Turkish troops go through the northern part of Iraq under Kurdish control to reach a predominantly Sunni Muslim desert area stretching west of Baghdad to the Syrian and Jordanian borders, where Turkey expects its peacekeepers to be stationed.

This time, however, it is not only the Kurds who are twitchy about Turks entering Iraq. The country's Shia and Sunni Arabs both have bitter historic memories of the Ottoman Turks, who dominated them until the end of the first world war. Several members of Iraq's Governing Council have suggested that Turkey wants to reconquer oil fields in Kirkuk and Mosul that were once in the Ottoman empire, and give warning that Turkish troops might be attacked by Arabs as well as Kurds.

A grumpy welcome

Turkish tankers carrying oil in the restive refining town of Beiji have already been attacked. Only last-minute arm-twisting by the Americans stopped the council from issuing a statement openly opposing a Turkish presence. Even Iraq's Turkomen minority, whose rights Turkey has promised to safeguard, are wary of interference from their big brother as they seek to forge new and hopefully fraternal relations with their fellow Iraqis.

Of the few Kurdish voices raised in support of Turkey's proposed deployment of troops in Iraq, none is more surprising than that of Osman Ocalan, commander of the 5,000 guerrillas of the Kurdistan Workers' Party (PKK) holed up in the rugged fastnesses of northern Iraq. He has been Turkey's public enemy number one since the capture and incarceration of his elder brother, Abdullah Ocalan, the PKK's founder, in 1999. The younger Ocalan has been making polite noises about the Americans' efforts to bring stability and democracy to Iraq. If Turkish peacekeepers go to Iraq, he says, they are welcome to help the

Americans—provided they stay well away from his PKK fighters and keep their noses out of the affairs of all of Iraq's 5m-odd Kurds. “If their troops are stationed in [Iraq's] Arab areas and work for Iraq's stability they can make amends and we'll welcome that—and not attack them.”

However, Mr Ocalan, who has stayed with a band of guerrillas on the Iraqi side of the border on instruction from his imprisoned brother, is a lot less sanguine about the several thousand Turkish troops already based in the north of Iraq, where they monitor the PKK's movements.

Last month the PKK, which has renamed itself the Freedom and Democracy Congress (KADEK), called off a four-year ceasefire because it objected to the terms of a partial amnesty offered by the Turkish government. In response, Cofer Black, the American State Department's counter-terrorism chief, agreed with Turkish officials that the United States would take unspecified action against the PKK in Iraq, to make it easier for Mr Erdogan to send peacekeepers there. Mr Ocalan, probably correctly, does not expect an imminent attack on his mountain bases, since America's already stretched ground forces in Iraq are reluctant to open a new front, especially in the largely tranquil north.

Any American action would also upset the delicate balance of power in the north between Mr Ocalan's rebels and the two main Iraqi Kurdish groups, Massoud Barzani's Kurdistan Democratic Party (KDP) and Jalal Talabani's Patriotic Union of Kurdistan (PUK). The Americans see both those groups as valuable allies. Their leaders are upset by the prospect of Turkish troops passing through. In February, more than 500,000 Kurds took to the streets of Arbil, their regional capital in Iraq, to protest against the idea of Turkish soldiers entering the north alongside the Americans.

While calling for calm over the issue of Turkish troops, Mr Talabani, a member of the Governing Council, notes that most Iraqis are loth to have troops from any neighbouring countries, including Syria, Jordan and Saudi Arabia. “We want good relations with Turkey,” he says. “But we want to see Turkish businessmen and traders here in Iraq—not the Turkish army.”

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Kenya's government

Going wrong?

Oct 9th 2003 | NAIROBI
From The Economist print edition

Kenyans are already disappointed in their new government

WHEN she heard the shots, Catherine Mbai couldn't believe her ears. Then she found her father, Odhiambo Mbai, a leading political scientist, gurgling blood on the sofa downstairs. As Kenya's president, Mwai Kibaki, flew to Washington this week, he left behind a nation in shock. He is the first African leader to be granted a state visit by George Bush, as a reward for his election win over the kleptocratic regime of Daniel arap Moi last December. Yet the apparent assassination last month of Mr Mbai, a key man in efforts to redraft Kenya's lumpen constitution, has invoked memories of Mr Moi's darkest days.

Three men have been charged with the murder, but not the senior government figure they accuse of hiring them. Three top people from the *East African Standard* newspaper were also arrested after publishing one of the suspects' confessions—minus the alleged paymaster's name. Mr Mbai's fellow delegates to Kenya's constitutional review team have since accused ruling politicians of bribery and intimidation. The team's final conference, which was expected to result in the paring back of the presidency's now almost limitless powers, ended fruitlessly, and will reconvene in a month.

What a waste. Though bitterly tribally divided, degraded and impoverished by Mr Moi's incompetence and graft, Kenya is still the region's biggest economy and brightest hope. With just a few vital reforms, it was always said, the country's industrious peasants and enterprising middle class would flourish again. Mr Kibaki promised judicial reform; an anti-corruption authority; privatisation of state-owned utilities; and approval, within 100 days, of a new and already-drafted liberal constitution. Most Kenyans believed him. According to a Gallup poll in January, of 65 nationalities surveyed, Kenyans were the most optimistic about the year ahead.

Shortly after his election, Mr Kibaki, aged 72, a keen drinker and high-handicap golfer, suffered his fourth stroke. All the same, he started quite well. He fulfilled another campaign pledge to make primary-school education free for all. Two of Mr Moi's pocket judges, including his loutish chief justice, and the central bank chief were forced out. The anti-corruption authority was set up, though without the power to prosecute. An inquiry into Kenya's biggest scam, the Goldenberg scandal, which involved the theft of over $500m in compensation for bogus gold and diamond exports, was reopened. So were Mr Moi's torture chambers in Nairobi, though this time to a sombre public, many of whom filed through the cells in tears.

But, failing the introduction of the more fundamental reforms heralded in the draft constitution, such as devolution and an independent judiciary, these piece-meal measures are starting to look like mere crowd-pleasers. A tangle of inquiries has been launched into past government swindles and half of the country's judges were this week urged to resign. Yet no minister in the new government, which includes several of Mr Moi's former toadies, has been charged. The Goldenberg scandal damaged the reputation of George Saitoti, who was Mr Moi's finance minister and vice-president at the time, yet he is still in government, as education minister. Indeed, he was very nearly reappointed vice-president, following the AIDS-related death in the summer of Mr Kibaki's first number two, Michael Wamalwa. Nor does corruption near the top appear to have ceased. And the promised sale of state assets, notably of the rotten state telecoms company, has barely been mentioned.

At the heart of these contradictions lies the venomous tribal politics that Mr Kibaki vowed to end. This is hardly surprising. As the election showed, Kenyan politicians are among the last in Africa to campaign flagrantly on the basis of tribe. Yet the speed with which Mr Kibaki's presidency has become synonymous with the interests of a small group of his Kikuyu tribe, Kenya's largest, and its cousins from the Mount Kenya region is extraordinary. This may be largely due to the president's frailty. Always prone to indolence, Mr Kibaki seems periodically befuddled because of his recent strokes. Weighing up his mental

faculties, one diplomat commented, “Let's just say I wouldn't give him a clerical job.”

Family friends

The Mount Kenya mafia, as the Kikuyu cabal became known within weeks of Mr Kibaki's inauguration, appears to have renounced reform in favour of shoring up its ailing patron's power. In particular, its members seem determined to shut out Raila Odinga, a firebrand leader of the Luo, whose pre-election defection to Mr Kibaki delivered him victory. At the time, Mr Odinga was promised the powerful prime ministership outlined in the draft constitution. Hence, perhaps, some of the disruptions to the recent constitutional review conference, of which the murder of Mr Mbai, a Luo, was just the most brutal. The conference was suspended for two weeks of national mourning, following the death of Mr Wamalwa. Whole days passed in flatulent debate on minor issues. As the review process approaches its final round, concedes its weary chairman, Yash Pal Ghai, it could easily be sabotaged entirely.

That may not put off western donors, who withdrew from Kenya in 2001 and are itching to return. The World Bank has already declared itself ready to re-engage, and on November 3rd the IMF is expected to approve a credit for $240m. But ordinary Kenyans are already disappointed with Mr Kibaki's drift. From the AIDS-ridden shanties on Lake Victoria's fertile shore to crumbling tourist resorts on the paradisal Indian Ocean coast, and especially in Mr Mbai's Nairobi home, where 21-year-old Catherine was grieving, they had expected something so much better.

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Crime in South Africa

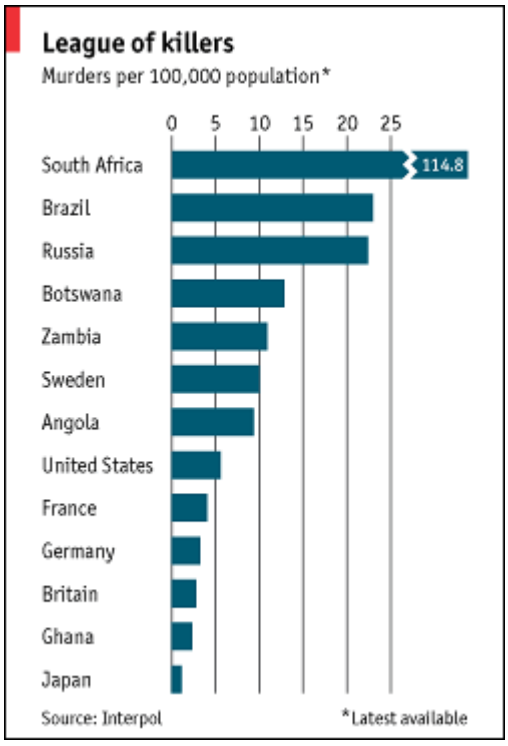
Small mercies

Oct 9th 2003 | JOHANNESBURG
From The Economist print edition

New figures offer a crumb of comfort

"OPEN your palms and hold your arms up in front of your chest. It shows submission—and the bones in your forearms might deflect a bullet." That, apparently, is how best to step out of your car during a robbery. The anti-hijack instructor from carmaker BMW offered several such tips in a lesson for drivers in Johannesburg last week. Consider fitting a luminous emergency release handle in the boot, in case robbers lock you in it. Don't try silly James Bond devices like flame-throwers or slashing blades on the sides of the car: firms that once used to fit them are bankrupt, so maintenance is tricky.

Most important, know the risks and take precautions. According to new national crime figures, carjackings rose 12% last year in Johannesburg, where 2,990 cars were snatched. Crime statistics make such gloomy reading that the government now refuses to publish them more than once a year. The minister for safety and security, Charles Nqakula, says he withholds some statistics since "combating crime does not rely on figures".



But there are crumbs of comfort hidden in these ones. The most reliable statistic is for murder, which is almost always reported. More than 21,000 people were killed last year, roughly the same number as in 2001. That is worse than some war zones—and is probably still the highest rate in the world. But population growth means that the per capita murder rate dipped a shade. Compared with ten years ago, when political violence was rife, it is much lower. Some other violent crimes, such as rape, also appear to be down, though statistics that depend on reports from the public are less reliable. The police guess they hear of only one rape in three.

Everybody knows that reducing violence more sharply depends on fighting a wide range of problems. Carjacking is mostly organised by syndicates of thieves who export to other bits of Africa. Corrupt customs officials and police let them do so. Most killings take place in townships where drink, drugs and weapons breed violence. Extremely unequal distribution of wealth too often puts temptation—a new BMW that stops at a traffic light, for example—in front of jobless young men with weapons. When caught, criminals are handled by a slow and overburdened justice system: only 18% of murder cases lead to a conviction. Some 180,000 inmates are crammed into prisons built for 110,000.

But some useful measures are being taken. More police are being trained; companies donate cars and equipment. In central Johannesburg, street crime has fallen by 80% in three years and bank robberies have all but stopped after 200 closed-circuit cameras were installed to film every street. The government also proposes a firearms control law to restrict, though not ban, ownership. That might help choke the supply of stolen weapons to crooks; over half of all South Africa's murders are committed with guns.

One somewhat hopeful sign is that very little crime is now political. A decade ago nearly 4,000 deaths were blamed on political clashes, whereas last year just 52 were. At the end of last month the government issued a 500-page report on attacks and murders of farmers, concluding that 1,500 killings since 1991 were largely by robbers without a political motive. White farmers tend to see the attacks as part of a broader plan to chase them out. It is more likely that criminals see remote and ill-protected farms simply as soft targets.

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Russia and Chechnya

Vote for the devil

Oct 9th 2003 | ALKHAN-YURT, GROZNY AND TOLSTOY-YURT
From The Economist print edition

AP

A blatantly rigged election heralds more strife in Chechnya—and more bad news for believers in Russian democracy

Get article background

AKHMAD KADYROV (shown above) is now the elected president of Chechnya—just as Saddam Hussein was once the elected president of Iraq. Officially, Mr Kadyrov won 81% of the votes on October 5th, on a turnout of 88%. In fact, the election was so plainly fixed as to be farcical, were the outcome not so tragic for Chechens. It also augurs ill for elections to Russia's parliament, the Duma, in December, and to the Russian presidency in March.

Mr Kadyrov is a former mufti of Chechnya and one-time ally of separatist rebels with whom Russian forces have fought two wars since 1994. For the past three years he has been the Moscow-appointed administrator. In that time he has built up his own ragtag private army, made up of former rebels, ex-policemen and soldiers. “Two years ago things were clear—there were federal forces and rebels, and the federal forces were committing most of the worst human-rights abuses,” says Tanya Lokshina of the Moscow-Helsinki Group, a Russian human-rights organisation. “Now it's more confused; there are also Kadyrovites of all stripes, and a lot of the abuses you hear about are theirs.”

Kidnappings and murders are common. “Yes, we leave the house not knowing whether we'll come back in the evening, but you get used to that,” says a local television worker, who gives his name only as Magomed. Most abuses go unpunished (save by retribution from the victim's own clan) and often unexplained. The armed men at roadblocks or tearing around in cars firing in the air may be soldiers, police, Kadyrovites or rebel sympathisers—and their victims may be random.

In the run-up to the election, Mr Kadyrov's opponents were frequent targets. Among them were the head of a small village who had spoken out against vote-rigging; two workers for an opposition candidate, Malik Saidullayev; and the son of another, murdered on September 9th as he drove into Grozny, the capital. Armed men came to Naip Khayauri's house to tell him they had killed his son (and to rake his house with gunfire) in a car bearing no number-plates but plastered with a campaign poster for Mr Kadyrov. When Mr Khayauri checked on the case nearly a month later, he says a prosecutor told him there was none. He asked who had killed his son. “You know perfectly well who killed your son,” came

the reply, “and you want me to tell you?”

The Kremlin was determined that Mr Kadyrov would win. Russians' war-weariness over the fighting in Chechnya helped to propel Vladimir Putin into the Russian presidency in 2000; he will not let the place threaten his re-election in March. At one point Mr Kadyrov had three plausible challengers, all living in Moscow but with strong support in Chechnya. At Mr Saidullayev's mansion in Alkhan-yurt his campaign manager, Mukhamed Arsanukayev, says his boss was persuaded to run by Sergei Yastrzhembsky, an aide to Mr Putin. But by September, another Kremlin official was pressing Mr Saidullayev to withdraw. He refused. A court then disqualified him, because some voters who signed his candidacy petition had not put “Chechen Republic” in their addresses. The other two main contenders—Khusein Jabrailov, another businessman, and Aslanbek Aslakhanov, the Duma deputy for Chechnya—promptly got the message and quit.

In Chechnya itself, government workers tell of being ordered to vote for Mr Kadyrov or lose their jobs. Polling-station officials known to have opposition sympathies were visited at home, with grimmer threats. People were told to support Mr Kadyrov if they wanted their pensions, or pay-outs from a fund set up to compensate war victims. Mr Kadyrov is said to have given cars to local officials. Television stations virtually ignored other candidates; the new election law requires equal coverage for all, but the courts refused to consider their complaints. Mr Arsanukayev even tested this system out by submitting complaints with identical wording to those filed, successfully, by Mr Kadyrov's staff.

All this, one might think, would be enough to scare people into backing Mr Kadyrov. Yet on election day, Grozny's streets were empty compared with the days before and after, even though both were holidays. At a polling station in the city's bombed-out centre, a member of Mr Kadyrov's campaign team admitted that “since the main participants departed, the elections have lost all interest and attraction for the voters. The turnout is minimal...most people would rather vote for the devil than Kadyrov.” He estimated that only 50 people had voted at that station by mid-morning, though the official register already showed 350. A guard at another station estimated that no more than 700 people had voted by day's end. The official tally: over 1,900, 200 of whom voted in the final hour (when the guard counted ten), with nearly 90% backing Mr Kadyrov.

The official results attained Soviet-style absurdity. Turnout in the deserted capital was 98%. It was the same in the nearby Zavodskoy district, a stronghold of Wahhabites, the Islamic radicals whom Mr Kadyrov has sworn to wipe out. Abdullah Bugayev, one of the remaining opposition candidates, got 6% overall, but barely more than 1% in the north-western Nadterechny district, one of his supposed strongholds. “One would hope,” declared an official from Russia's federal elections committee, “to see such levels of propriety, lawfulness and *glasnost* in many other regions.” He was not being ironic (see article).

Rule of awe

Mr Kadyrov's enthronement allows the Kremlin to close a chapter of Chechen history. A referendum in March (also rigged, though perhaps unnecessarily) reiterated Chechnya's status as part of Russia, after it had declared independence in 1991. Mr Kadyrov replaces Aslan Maskhadov, who was elected in 1997 but

is now just one of many rebel commanders. The local and federal authorities are in talks to grant Chechnya what Mr Putin has called a “high degree of autonomy”. This will allow him to claim that he has brought the Chechen conflict to an end—even though dozens of Russian soldiers continue to die each month—in his re-election campaign.

What then? Mr Kadyrov is despised not only by the populace, but by many in the Russian army, for his old links with the rebels, as well as by the rebels he later turned against. That makes him a weak leader, easy to blame when things go wrong. Shamil Beno, a Chechen foreign minister during the republic's brief period of independence, thinks that Mr Kadyrov will be out before his term ends.

Yet a weak leader in a lawless republic is likely to use any means he can to keep control. So Chechnya will carry on much as before: a corrupt, unstable mess of competing armed bands, fighting over oil, selling arms and terrorising the population.

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Another Russian election

The Kremlin wins, again

Oct 9th 2003 | ST PETERSBURG
From The Economist print edition

The governor's election was a joke, but the result may mean more peace for all

EPA

Valentina, in Catherine's shadow

ALTHOUGH she won the election for governor on October 5th, Valentina Matvienko can have no illusions about what the people of St Petersburg think of her. Turnout in the election's first and second rounds was less than 30%; fewer than a fifth of registered voters picked her. Yet, considering her performance last time she ran for governor of the city, in 2000, that is not so bad. Then she was so unpopular that President Vladimir Putin showed his support for her challenger, Vladimir Yakovlev, by visiting him shortly before the election. That prompted her to withdraw from the race.

This time Mr Putin not only visited Mrs Matvienko; he endorsed her publicly (which triggered a lawsuit—swiftly thrown out—from her opponents). So did most local luminaries and the media: one television news programme two days before the first round carried four items, all mentioning her but none of her opponents. (That, too, is against the law.) But the low turnout still showed the election for the farce it was.

St Petersburg has a special status, both as Russia's architectural (and once real) capital, and as Mr Putin's home town. Who runs it matters. Mr Yakovlev had beaten Mr Putin's former boss, Anatoly Sobchak, in 1996, and by 2000 was too entrenched to kick out. But the city and the federal administration repeatedly squabbled. Earlier this year, Mr Putin rewarded Mr Yakovlev with a job widely seen as a poisoned chalice: deputy prime minister in charge of housing, construction, utilities and transport.

Having made a mess of some of those things as governor, Mr Yakovlev was unpopular in St Petersburg too. But Mrs Matvienko, born in the Ukrainian provinces and with a career as a diplomat and bureaucrat, has almost no links with the city. Even so, many Petersburgers grudgingly admit that the outcome may be for the best. Mrs Matvienko must stay loyal to Mr Putin—the more so given how little support she has in the city. Unlike Mr Yakovlev, therefore, she will enjoy the Kremlin's backing. Many Russians think that is worth more than anything, even democracy.

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Europe's stability pact

Stabbed

Oct 9th 2003 | BRUSSELS
From The Economist print edition

A slow, lingering death

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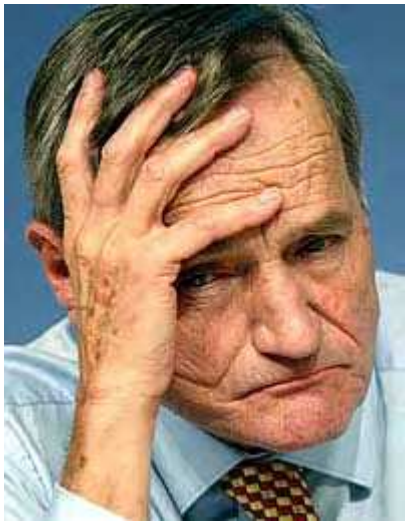
Reuters



Mer cocks a snook

THIS is not the end of the European Union's “stability and growth pact”, but it is probably the beginning of the end. Under the rules, the governments of the 12 countries in the European single currency, the euro, are obliged not to run budget deficits bigger than 3% of GDP. If they breach the limit for three years running, and cannot plead the extenuating circumstances of a severe recession, the pact provides that they should be fined billions of euros.

France's stated intention to run a deficit of more than 3% in 2004, the third year in succession, has now forced matters to a crisis. In theory, if the legal procedures are followed, the remaining euro members could vote through financial sanctions as early as next January. In practice, this is most unlikely. The supposedly iron fetters of the stability pact are turning out to be made of something rather more flexible, like jelly.

This being the EU, the procedure is complicated. Last June the European Commission noted that France was on course to breach the 3% ceiling in 2004 and issued recommendations to bring matters under control. On October 8th the commission declared that France had failed to follow its June advice, so it would now move to the next stage in the “excessive deficit procedure”. This involves binding recommendations that would then be put to EU governments for approval, probably on November 4th. If the French take no action on these recommendations within two months, fellow governments are supposed to consider imposing financial sanctions early next year.

But the commission is likely to suggest only recommendations that France can accept, in order to avoid a confrontation. It will shy away from insisting that Francis Mer, the French finance minister, take genuine measures to get the deficit below 3% next year. Instead it will accept his promises to restore budgetary discipline by 2005, in exchange for further token cuts in spending next year.

Smaller countries may be upset by such leniency. The Portuguese were censured under the stability pact, and others have made strenuous efforts to comply with it—so why should Mr Mer be allowed to cock a snook at the rules? A Dutch spokesman in Brussels says his government believes that the commission is legally obliged to recommend measures to bring France below 3% in 2004; if the commission fails in its duty, the Dutch government would consider taking the commission to court “as a last resort”. Yet at a meeting this week, most European finance ministers leant in the opposite direction—they would not approve sanctions, even if the commission were to propose them.

So is this the death of the stability pact? Thus far, the commission has played things by the book. But if its recommendations prove as feeble as seems likely, that would be a big slide away from the rules. The pact might then evolve into a rough guide to action, rather than the precise legal instrument its framers had sought. However, there is one way in which this scenario, allowing the pact to die a slow but relatively dignified death, might come unstuck. Mr Mer's prediction that he will bring the deficit below 3% of GDP in 2005 looks doubtful. And commission officials insist that if France breaks the rules for four years in a row, sanctions really will become a serious prospect. Really.

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Poland's economy

A costly recovery

Oct 9th 2003 | WARSAW
From The Economist print edition

Poland faces a struggle to put its fiscal house in order

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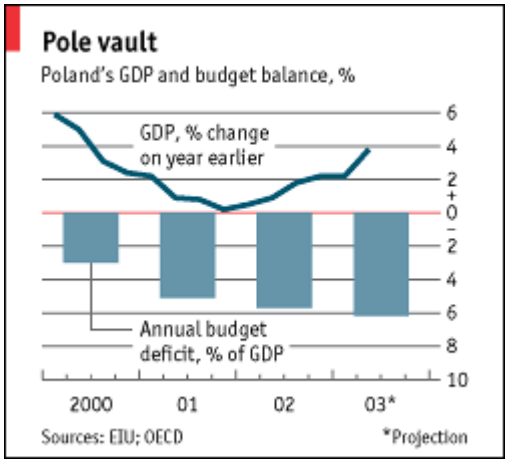

JUST a few weeks ago it seemed that Poland's economic outlook was rosy. The economy grew by nearly 4% in the year to the second quarter of 2003, fuelled by buoyant exports and private consumption, and it seemed likely to keep up that pace. This is its fastest growth surge since the late 1990s boom ended. As business picked up, the stockmarket rose, by a sharp 18.5% in August alone. Those economists who had scoffed at the (ex-communist) centre-left government's forecast of at least 3% growth this year now admit that the target will be met comfortably.

Yet summer chirpiness has given way to autumn gloom. The problem is the government's shambolic public finances. The zloty has fallen to its lowest-ever level against the euro, as financial markets take fright. A member of the central bank's monetary policy council has even spoken of a “national crisis”. This week, the economics and labour minister, Jerzy Hausner, belatedly unveiled promised plans to cut spending, by as much as four percentage points of GDP over 2004-07. But the details lacked credibility, and the markets remain unconvinced.

All this is a further blow to the prime minister, Leszek Miller, who had already been enfeebled by a string of corruption scandals. It was only in June that the finance minister, Grzegorz Kolodko, resigned after a row with Mr Hausner. Mr Miller sided with Mr Hausner and put him in charge of all economic policy.

Despite this week's burst of apparent fiscal austerity, Mr Hausner has proved as willing as, say, any French finance minister, to flout the fiscal rules that Poland and other countries due to join the European Union next May are supposed to obey—notably to keep budget deficits under 3% of GDP if they are to join the euro. An expansionary budget for next year will bring down the corporate-tax rate from 27% to 19% and increase the deficit to an admitted 5.3% of GDP (or over 7%, if disguised spending is included). A recent report from the finance ministry has conceded that Poland's public-debt-to-GDP ratio will come perilously close next year to the 60% ceiling that is both fixed by the country's constitution and laid down as one of the Maastricht criteria for qualifying for the euro. Even if his plans are implemented, which is unlikely, Mr Hausner's new cuts will make only a small difference.

Foreign investors fear that a fiscal crunch is looming, and that this week's measures may not fend it off. Moody's, a rating agency, says that “large mandatory expenditures in the budget”, especially “generous social spending”, must be curbed. It adds that recent attempts to trim the deficit have focused more on raising taxes than on cutting spending.

Mr Hausner claims to want to redress that balance. One acid test is how brutally he reforms Polish farmers' fraud-ridden and state-subsidised social insurance fund, known as KRUS, which exempts all landowners, including rich ones, from contributing. Disability benefits, which according to a World Bank report eat up no less than 4% of GDP every year, also need trimming. That means reassessing the 2.5m or so beneficiaries, many of whom cheat. “Streamlining these two programmes would generate huge savings,” argues Malgorzata Markiewicz of CASE, an economic think-tank in Warsaw. But the politics of doing it will be testing.

Parliament has many MPs from populist and peasant parties, and Mr Miller's Democratic Left, whose poll ratings have slumped, is loth to take unpopular measures before general and presidential elections in 2005. Besides, unemployment is stuck at around 20%. Both the reforms that Mr Hausner wants to make and his spending cuts may yet end up pending in the next government's in-tray. And by then Poland's official aim of adopting the euro in 2008 may be a forlorn hope.

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Italy's pension reforms

Berlusconi burlesque

Oct 9th 2003 | ROME
From The Economist print edition

Not for nothing do they call the man a populist

Get article background

AFP

Blowing a raspberry at Silvio

UNDER fire on pension reform, and sensing that this issue could make or break his government (it helped destroy his previous one in 1995), Silvio Berlusconi has announced that he will write to every household in Italy explaining his plans. That may not be a bad idea. For he faces more than the usual resistance of trade unions, who have called a four-hour general strike on October 24th. He faces more even than the habitual vacillation of his allies who, having agreed a modest compromise after tortuous negotiation, are now trying to water it down again. His real problem is that he is up against public opinion.

Pensions absorb 14% of Italy's GDP, the highest share in any big European country. They thus siphon off cash that could be more productively used elsewhere. Yet, in a poll for *Il Messaggero*, a Rome newspaper, only 25% of those questioned would accept more than “minor corrections”.

Behind that response lie some deep-seated cultural attitudes. The thrust of the government's reform is to persuade Italians to retire at an age that would be considered normal in most other countries. From 2008, a full state pension would kick in only at the age of 65 (for men) and 60 (for women), or after 40 years' worth of contributions. It would still be possible to retire, as now, at 57, or with 35 years' worth of contributions. But that would mean accepting a lower pension.

The trouble is that Italians, particularly in the north, are now used to the idea that it is their right to stop working in middle age. That seems odd, given that advances in medicine now allow 65-year-olds to expect 15 years or more of retirement. It is odder still in a country where so many leaders and opinion formers are well past normal pensionable age. President Carlo Azeglio Ciampi is 82. One of his predecessors, Francesco Cossiga, is still active in politics at 75. Italy's most revered newspaperman, Enzo Biagi, is still scribbling perceptively at 83. Even Mr Berlusconi is, at 67, no spring chicken.

Yet less than three in ten of their compatriots over the age of 55 holds a (legal) job. Even allowing for employment in Italy's extensive black economy, that figure is exceptionally low. As a first step towards raising it, Mr Berlusconi's reforms propose that, from January 1st, anybody of pensionable age who chooses to stay at work will get a bonus worth 32.7% of their salary, representing the cash they would otherwise have taken for their pensions.

Yet when asked by *Il Messaggero*, only 28% said they would take the money rather than opt for the deckchair. Italians may not be lazy; but they certainly have what economists call a high leisure preference. And that may be harder for Mr Berlusconi to tackle than even the noisiest protests.

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Germany's bureaucracy

Breathe or be strangled

Oct 9th 2003 | BERLIN
From The Economist print edition

The government declares war on red tape—and may win a skirmish or two

IF ESKIMOS have dozens of words for snow, Germans have as many for bureaucracy. The most popular is *Amtsschimmel*, a word of obscure origin that translates roughly as “the office horse”. The government declares that it is bent on chasing these clodhoppers out of Germany. But has it any more chance of success than in the past? The Institute for the German Economy, the research arm of the country's business associations, hopes so, if only because the economy might be strangled to death unless red tape is loosened.

Germans are fed up with forms and rules. Pollsters at the Allensbach Institute say that as many as 90% of Germans have had rows with bureaucrats, up from 64% in 1978. *Bild*, Germany's biggest tabloid, recently sent out a reporter in search of ridiculous rules. One example: a tailor who had to put up a sign saying “fire extinguisher” next to (guess what) her fire extinguisher, to produce a thick folder with all regulations relevant to her business, to raise her work table by ten centimetres, to buy a special emergency kit, and to check if her only employee was allergic to nickel—at a cost of €400 ($428).

Germany is, in short, one of the most rule-bound countries in the world. And that is bad news for the economy, particularly for entrepreneurs hoping to set up in business. A new World Bank study, “Doing Business in 2004”, illustrates the problem (see article). The study shows that it takes an average of 45 days to register a new firm in Germany, compared with 18 in Britain and only four in America. The process is also cheaper in America, Britain, Canada and France than in Germany.

The government has launched a “masterplan for reducing bureaucracy”, listing dozens of cases where archaic rules should be scrapped or simplified. It recently brought in a bill to do away with such workplace regulations as where to put light switches or the shape of rubbish bins. The government has also chosen three regions where some laws will be suspended while local and federal agencies try out alternatives.

Yet it will take years for Germany to match America and Britain. Germans may inveigh against bureaucrats, but they have a soft spot for state mollycoddling. In any case, over a third of the members of the federal parliament are former civil servants, hardly likely to be in the forefront of a campaign to cut bureaucracy. Even some businessmen are ambivalent, for regulation can be a useful barrier to competition. The supposedly free-market opposition has attacked government plans to loosen laws protecting guilds of architects and craftsmen from competition.

The language of officialdom hardly helps. A recent example of cutting red tape was a law to speed up approval for building roads. Its name: *Verkehrswegeplanungsbeschleunigungsgesetz*.

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Charlemagne

Why is this happening?

Oct 9th 2003
From The Economist print edition

Claims that the new constitution is designed to cope with European Union expansion are false

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JOURNALISTS arriving at Rome's Palazzo dello Sport to cover the opening of the European Union's constitutional conference on October 4th were greeted by fine examples of 1930s art and architecture. Outside the building stood a statue of an athlete giving a fascist salute. Next to it a stone frieze of heroes included the balding, barrel-chested figure of Benito Mussolini, Italy's dictator at the time the hall was built. Any European heads of government who found these surroundings a mite unsettling will doubtless have been reassured by the opening address from Silvio Berlusconi, the balding, barrel-chested prime minister of today's Italy. Mr Berlusconi told his fellow leaders that “this is the conference of European will, the will of Europe to be Europe.” Keen to ensure a triumphant outcome, he urged the conference to come up with a “quality agreement”.

But why is it necessary for the EU to adopt a constitution at all? Mr Berlusconi was vague about this, stressing only the need for Europe to “rediscover its ancient leadership role.” Pressed for more precise reasons, most of the assembled heads of government pointed out that in May 2004 their club will expand from 15 to 25 members, when ten new countries, most of them ex-communist ones from central and eastern Europe, join. “Enlargement and the constitution are two sides of the same coin,” declared Gerhard Schröder, Germany's chancellor. Jack Straw, Britain's foreign secretary, insisted that a constitution was needed “in order to make enlargement work better.”

Superficially this sounds plausible. But look more closely at the big new ideas in the draft text on the table and it becomes apparent that they have very little to do with enlargement. Why does an increase in the number of countries in the Union require the creation of a European foreign minister? Or the adoption of a legally binding Charter of Fundamental Rights? Or an expansion of EU powers into the field of criminal law? Moreover, all the legal and institutional arrangements needed to cope with enlargement were, in fact, settled by the Treaty of Nice, which was agreed less than three years ago. EU heads of government then declared proudly that Nice “opens the way for enlargement” and “completes the institutional changes necessary for the accession of new member states.” They went on to agree that another inter-governmental conference (IGC) was needed, but only to consider four issues: “a more precise delimitation of powers” between the EU and its members; the status of the Charter of Fundamental Rights; simplification of the EU treaties; and “the role of national parliaments in the European architecture.”

Yet somehow the European Union has moved from this short list of four leftovers to a full-blown constitution. How has this happened? The answer is that the drive to write a European constitution is indeed connected to enlargement, but in a quite different way. European federalists have long feared that enlargement might utterly destroy their dream of an EU that evolves into a political union, with a genuine economic government and a unified foreign policy, particularly since many central Europeans are suspected of harbouring an outmoded attachment to national sovereignty. Alarmed by this, federalists launched a successful drive to turn a limited discussion of the Nice leftovers into a full-scale effort to write a constitution.

That is why the 2001 Laeken summit set up a convention on the future of Europe to precede the IGC. The (correct) assumption was that this would generate the momentum to write a constitution. An accelerated timetable was also pushed through. At Nice it had been agreed that the IGC would take place in 2004. That date was brought forward to 2003, largely so that the work on the constitution could be completed before the newcomers joined the Union.

Consistent with this, at the constitutional convention, every effort was made to limit the influence of the newcomers. Their representatives were present on the convention floor, but not on the 12-person presidium that did the crucial work of drafting the text—although the presidium was eventually shamed into adding an “invitee” from mighty Slovenia to its numbers. It is no coincidence that some of Europe's most prominent federalists, such as Joschka Fischer, Germany's foreign minister, and Guy Verhofstadt, Belgium's prime minister, are now pushing hardest for the convention's draft constitution to be adopted swiftly and without alteration.

Federalist failure

Lest this analysis seem overly conspiratorial, it should be conceded that in many key respects the federalist effort has fallen short. Such crucial goals as the drive for taxation and foreign policy to be decided by majority vote have not made it into the draft constitution. It has also proved harder than had been hoped to shut pesky central Europeans out of the process. Although, legally speaking, they have no right to vote on the new constitution, since it will be finalised before they formally join the Union next May, political reality gives each of them what amounts to a veto, since all their parliaments will have to ratify the new constitution. Indeed, the Poles (in alliance with the Spaniards) are already giving their EU partners a big headache by bluntly refusing to accept provisions in the constitution that would dilute the voting strength they won at Nice.

Whatever the intellectual merits of their position, it is entirely understandable that the Poles are in no mood to roll over and accept a constitution that has been drawn up with such scant regard for their views. If European leaders were really serious about adapting the EU to enlargement, it would surely have made more sense to let the new members into the EU, give the present system a few years to operate and then decide what needs to be fixed. Ramming through a series of pre-cooked ideas, based on a federalist agenda that has barely altered since the 1950s, is an odd way to go about things.

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Immigration

The natives are restless

Oct 9th 2003
From The Economist print edition

Immigration looks like a hot-button issue, but no mainstream politicians want to press it. Wisely

Get article background

RACE and immigration lurked at this year's party conferences like uninvited guests. Nobody quite mentioned them by name, although delegates clearly knew they were there. Theresa May, the Conservative Party chairman, briefly raised the spectre of Enoch Powell—the party's late 1960s anti-immigrant firebrand—but only to gloat over the appointment of an Asian candidate in his old constituency. Oliver Letwin, the shadow home secretary, nodded at the vexed asylum issue, calling for quotas and offshore processing of applicants. But that was as far as it went. There was no talk of immigrants swamping the country, no vision of fortress Britain.

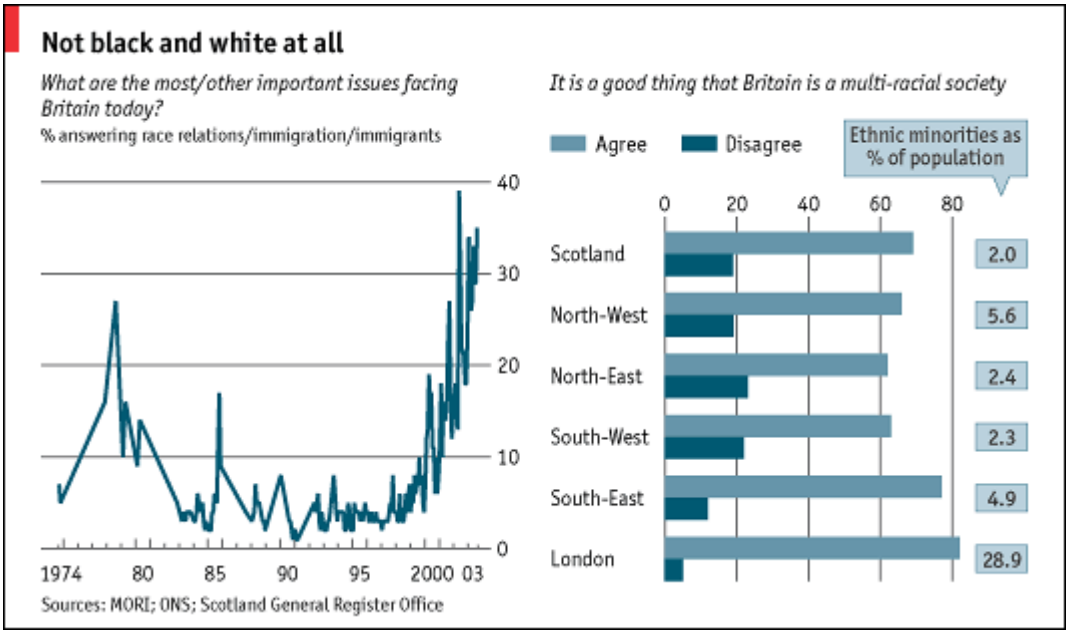
This is odd, given the seeming strength of public opinion on the matter. The number of people citing race and immigration as important issues facing the nation has risen rapidly in the past few years (see chart). Polls show levels of concern higher than in the 1970s. Two recent polls by YouGov and MORI found that more than 80% of all people (and 59% of black and Asian Britons) saw immigration as out of control.

So far, though, the chief beneficiaries of the hardening mood have been the “brutes in suits”—chiefly the far-right British National Party (BNP), which stands for the repatriation of all non-whites. It and similar parties have amassed 18 seats on local councils, and will probably add to their tally next week, when elections are held in Bradford, Burnley and Calderdale.

If that success shows that there is anti-immigrant fruit for the picking, why aren't the main political parties reaching for it? Both Labour and the Tories have wobbled on this issue in past decades.

One reason is that in some of the most ethnically mixed parts of the country, assimilation has done a lot to dissolve prejudice. London, which has both ethnic minorities and refugees in abundance, used to be a place where the far-right enjoyed a toe-hold. Now the capital consistently displays the lowest levels of intolerance of any region in the country.

Feelings are strongest in regions where an ethnic divide is accentuated by poverty, and the resulting competition for access to public services. Media hype plays a role too, in northern and south-western regions where there are few non-white faces and fewer asylum-seekers. Last year, the BNP won nearly 50% of the vote—its all-time best—in a council by-election in Broxbourne, Hertfordshire. Yet this is an overwhelmingly white area with no known asylum-seekers. Burnley, a northern town where the BNP holds fully seven council seats (and took 11% of the vote in the 2001 general election) is just 7% non-white—under the national average.



All that partly explains why nobody is chasing the xeno-racist vote. The next election will be won and lost not in the intolerant distant provinces—which are, by turns, solidly Labour and fairly solidly Conservative—but in areas with lots of marginal seats such as the south-east and the Midlands, where attitudes are milder.

Moreover, the swing voters are a middle-aged, middle-class bunch increasingly unswayed by racial overtures. While the over-60s continue to report about the same levels of racial prejudice they displayed in the 1980s, younger generations are much more liberal, with 75% proudly declaring themselves “not at all prejudiced”—up from 60% in 1987.

Although often conflated, worries about uncontrolled numbers of asylum-seekers (which are widely felt) are essentially different from opposing immigration in general (a narrower concern). On both issues there is little to choose between Mr Letwin, fastidiously liberal at heart, and the authoritarian Labour home secretary, David Blunkett.

Ultimately, for all their tough talk on the manifest failings of Britain's decrepit asylum system, both main parties reckon anti-immigrant fruit is poisonous. Their distaste leaves the far-right parties with the chance to make headline-grabbing gains. That is nasty, but, given the way most of the public thinks, not dangerous.

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Football

Boudoir bandits

Oct 9th 2003
From The Economist print edition

Scandals flare in British football. Who cares?

Get article background

FOR the livelier newspapers it is a winning mix—sex, drugs, sport and national self-flagellation. This week even the *Times* bemoaned "Another day of shame for football" on its front page.

The past fortnight has certainly been stuffed with bad news. Several stars are alleged to have been involved in the gang rape of a 17-year-old at a top-class hotel in London. The tabloids have been salivating over stories about orgies after matches. A player from another top club has been arrested on a different sexual-assault charge.

And as the English national team prepared for a crucial match against Turkey on October 11th, Rio Ferdinand—the world's most expensive defender—was dropped for having failed to take a random drugs test. His colleagues reacted by threatening to strike, thus confirming the popular image that they are over-paid brats who think that normal rules should not apply to them.

So what? Like professional athletes in the United States, top English soccer players are hugely well paid, seriously under-educated and have time on their hands. No wonder some of them get into trouble.

But is there something in Britain's hard-drinking, laddish culture that makes the country's footballers particularly likely to run into trouble? Some contrast such feckless and loutish behaviour with the allegedly more disciplined and professional attitudes of their continental European counterparts. It is certainly true that foreign players who have fetched up in Britain have expressed amazement at the alcohol-fuelled culture they find there.

But hang on. Highly paid footballers outside Britain lead fairly colourful lives too. If the current rape cases lead to prosecutions, some of the defendants may turn out not to be Brits. And the two most iconic footballers in England—David Beckham and Michael Owen—are both famously uxorious and clean-living characters. Now, if either of those should run into trouble, there really would be a national crisis.

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Crime

Feds under the bed?

Oct 9th 2003
From The Economist print edition

Organised crime is thriving as competing agencies squabble

SENIOR police officers are becoming convinced not only that organised crime is a growing problem, but also that both the law and the agencies that enforce it are increasingly helpless against the top criminals. Restrictions on wiretap evidence, and gaps in police organisation, have left a group of 150 elite gangsters all but untouchable. Known as “core nominals” in coppers' parlance, they control rackets including drugs, prostitution, money laundering and immigrant smuggling. “They don't commit crimes themselves, they manage criminal enterprises,” says a senior police source.

Now a cabinet committee chaired by Tony Blair is considering the case for a national police force along the lines of America's Federal Bureau of Investigation (FBI). Its decision is expected in the next few weeks. The prime minister floated the idea three months ago at an international criminal justice conference, sparking a fierce turf war among the agencies concerned.

The National Crime Squad (NCS) says it has disrupted or dismantled nearly 1,500 criminal organisations, made 5,000 arrests, and seized drugs worth £1 billion ($1.6 billion) in its first five years of operations. It has 1,300 detectives, most on secondment from local police forces, and more than 400 support staff. They are currently involved in more than 120 investigations, most of which involve co-operation with other international forces.

The National Criminal Intelligence Service (NCIS), with a staff of 1,200, provides intelligence and analysis of organised crime to local police forces. The third main body is Customs and Excise, which reports ultimately to the Treasury. It has 2,500 investigating officers and concentrates on alcohol, tobacco, drugs and VAT fraud.In the past few days, all three agencies have submitted proposals to the cabinet committee.

Part of the problem is differing priorities. Customs and Excise's role is revenue gathering and the seizure of illegal drugs. At NCS the main task is the prosecution and disruption of organised crime syndicates. One recent operation busted a gang trafficking in heroin and cocaine but also involved in tax fraud, money laundering and armed robberies. If customs officers had followed their instincts and seized the drugs, the extent of the criminal network would not have been known.

On one point, at least, there appears to be agreement: the status quo is not an option. To have three national agencies, all collecting intelligence and all developing their own informers, is a recipe for overlap and confusion. The failure to share intelligence has occasionally led, say insiders, to acute embarrassment with criminal cases having to be dropped when an informer for one organisation is charged by another.

So where will the bureaucratic infighting lead? The Treasury, under Gordon Brown, backs its excisemen and tends to look sceptically at proposals endorsed by the Home Office headed by his rival, David Blunkett. Still, it looks as if Customs and Excise will be the loser. A separate review into its activities is currently underway, following a series of fraud cases which went disastrously wrong after informers' evidence was not disclosed to the defence. A High Court judge, Mr Justice Butterfield, has recommended that Customs should lose its powers to bring its own prosecutions.

The most likely result of the turf battle is that a completely new national police force will be set up, staffed and resourced by the current investigative agencies. A source close to the policy debate said that the new agency, whatever its name, had to create an image as powerful as that of America's FBI or the British military's SAS special forces. To have an impact, he said, the new outfit must develop “a combination of myth, brand and influence from the shadows”.

But the government's record on liberty and the law, especially in the use of its tough anti-terrorism powers, leaves many Britons feeling slightly queasy. Scaring the crooks but not the liberal-minded will be a tricky business.

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Prisons

Prisongate

Oct 9th 2003
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Locking people up in bad prisons is a costly way of making them worse

“PRISON works”, declared Michael Howard, addressing his first Conservative Party conference as home secretary. Not really. Ten years later, the prison population has increased by 60% to 74,000 but overall levels of serious crime recorded by the police have doubled (see chart). Of course, prison works to the extent that those who are incarcerated cannot commit further crimes while they are banged up. But as most prisoners spend less than three years in jail, the crucial question is what happens when they are released.

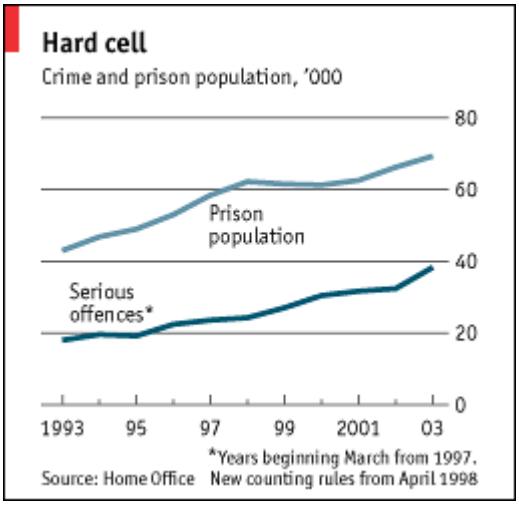
“Prisongate”, the memoirs published this week by Sir David Ramsbotham, a former chief inspector of prisons, is a damning indictment of Britain's shabby, crowded, and chaotic prison system. In a week which has seen serious disturbances at Lewes prison and an official report that some young prisoners in Northumberland are having to spend 22 hours a day in their cells, with virtually no access to vocational or skills training, it is timely stuff.

The cost of regurgitating bitter, often illiterate ex-prisoners without money, housing or hope of a job back into real life, seldom features in official calculations. Nearly 60% of all adults, 78% of young offenders aged 18-21 and 88% of children aged 15-17 are reconvicted again within two years of release. The real rates of recidivism are much higher because so few offenders are caught, let alone convicted. As a 1990 government white paper pointed out, prison is “an expensive way to make bad people worse”.

The result of this failure is considerable. More than a million crimes—nearly a fifth of all offences—are committed by released prisoners at a cost of at least £11 billion ($18 billion) a year. As the prison service costs nearly £3 billion a year to run, that looks poor value for money. Old prisons, dating from the Victorian era, often with staff attitudes to match, are peculiarly resistant to reform. Despite the prison inspectorate's repeated criticisms over a decade of poor conditions at Holloway, little has changed. The latest report on the largest women's prison in the country found that its inmates were only allowed to have showers twice a week, even those who were pregnant or had recently given birth.

At the end of June, 85 of the 138 prisons in England and Wales were overcrowded. That means more suicides—105 last year, the highest figure ever. Another sign of the mess is that sickness levels among prison officers (14.7 days per year) are the highest in the public sector.

A report by the Prison Reform Trust, published in August, showed that the prison service last year failed to meet eight of its 19 performance targets. In some areas, things are getting worse, particularly the amount of time inmates spend locked up in their cells. Last year they spent only 22.6 hours a week in “purposeful activity”—nearly an hour less than the year before. For the fifth year running, the prisons failed to meet their measly target for working with sex offenders; only 879 completed a treatment programme, against a target of 950, and a prison population of 5,000.



In a remarkable speech two years ago, the former director-general of the prison service, Martin Narey, spoke of a “litany of failure and moral neglect.” Mr Ramsbotham blames ministers at the Home Office, the civil servants who advise them, and the top officials who run the Prison Service. But in the end, it comes down to a lack of public pressure. That there are no votes in

prisons is an old saying, but one that is still sadly true.

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Pensions

Poor, old, confused

Oct 9th 2003
From The Economist print edition

Politicians are ducking the hard decisions on Britain's pension policy

SHARPLY contrasting visions of pensions were unveiled this week by the governnment and the Conservative opposition. But they had a lot in common as well: both are unsustainable.

The government's vision centres on its new pension credit, a means-tested scheme to top up benefits for poorer pensioners. The first payments from this system, which will cost around £2 billion a year, are just starting. Andrew Smith, the minister in charge, says this will help poor pensioners while rewarding those who have saved: the thrifty will now get more than those who have saved nothing.

The Conservative Party's vision is a bold plan to index the main state pension to growth in earnings, rather than the current link with price inflation. That is a big surprise; there used to be just such an earnings link—until the Conservative government abolished it in 1980. David Willetts, the party's pensions spokesman, said that the change would involve no net cost during a four-year term of office because of other savings, chiefly linking the means-tested pension credit to prices rather than earnings, and binning a “new deal” programme that aims, not very efficiently, to get jobless young people into work.

In the long term though, restoring the earnings link will be costly. John Hawksworth of PWC, an accountancy firm, reckons the overall cost of state-pension spending would rise by about 1.5% of GDP by 2050 (see chart). For the government, Mr Smith was quick to pour scorn on the Tories' new-found generosity.

Such criticisms would carry more weight if his own plans made sense. The assumption that pension costs will stay at only 5% of GDP over the next 50 years is unrealistic in most experts' view. The sums add up only if the state pension keeps shrinking in relation to earnings, with the pension credit making up the difference towards the bottom. Yet on that basis, almost 75% of pensioners would already be entitled to the credit by 2025, according to the Institute for Fiscal Studies.

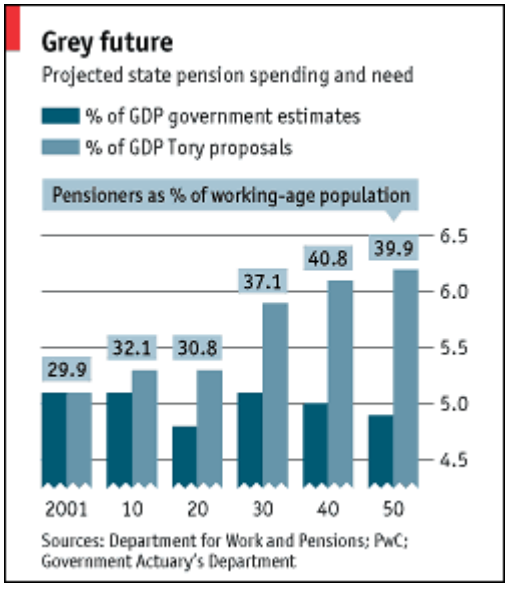
The government's projection is unfeasible because the number of pensioners will rise by 40% over the next 35 years. If they are to enjoy the same standard of living, relative to the rest of society, as retired people do today, the cost is bound to grow. Adair Turner, chairman of the government's advisory Pension Commission, says pensioners' share of national income (including both public and private sources) would have to rise from 9% of GDP to 13% in 30 years' time.

The Conservative plan implies that a big chunk of this increase will come through a tax-funded pension—an odd priority for a supposedly tax-cutting party. The Labour government's plans imply that all the additional money will come from the private sector. But the traditional means of supplementing a small state pension—the company schemes that offer pensions linked to years of service and final salaries—is withering away because it has become too costly and risky for firms.

Both proposals have some merits, but fail to confront the tough choices. The Conservatives' attack on means-testing is well founded, says David Blake, director of the Pensions Institute, a think tank: “the pension credit is an extremely complex attempt to get round an inadequate state pension”. But the opposition's solution, of restoring the earnings link, will not eliminate means-testing. The only affordable way to do that is to pay a higher pension, but at a later retirement age.

The government's approach will contain state-pension spending only if there is a big expansion in private saving. But while the means-tested pension credit does somewhat reward past thrift, it will discourage such behaviour in future. In effect, it taxes savings income at 40%, by withdrawing 40p from the top-up payment for every additional pound of private income. The only way to square means-testing and increased saving is to make that additional saving compulsory, says Mr Blake—a policy as unpopular as raising the retirement age.

The truth is that Britain's pension policies require a comprehensive overhaul. Simply tinkering with the existing system is not enough as people live longer and private employers reduce their commitment to pensions. Neither the Labour government nor the Conservative opposition is yet close to tackling the real problems.



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Housing

Flawed ceilings

Oct 9th 2003
From The Economist print edition

Where to build new houses? Whitehall does not always know best

Reuters

Prescott's castles in the air

Get article background

JOHN PRESCOTT, the deputy prime minister, likes big ideas. His ten-year transport plan tried (in vain) to revolutionise the way we travel by persuading drivers to abandon their cars. The same fate threatens his new vision, a big expansion of housing in the south-east.

Four development areas (see map) around Milton Keynes, Ashford, the M11 corridor near Stansted and the Thames Gateway (a new home for the estuary) are meant to provide another 200,000 homes in addition to the 900,000 already planned over the next decade. The case for building more houses in the south-east is that demand and prices are soaring. The cost of a house there has nearly tripled over the past decade: the average is about £200,000. That puts ownership beyond the reach of most low-paid workers. One answer would be a different tax regime, driving land values down. Another would be a freer labour market in the public sector: if teachers and nurses were paid more in the expensive south-east (and less in cheaper bits of Britain) they could afford somewhere to live.

But such ideas are not on the agenda. Instead the government is trying to cram the equivalent of 30 new towns into the most overcrowded part of Britain. That is unpopular with those who already live there, but the government will soon be able to override local objections, thanks to the planning bill now before Parliament.

Mr Prescott has lined up some powerful allies. The prime minister is chairing a cabinet committee which is looking at development proposals east of London, along the Thames estuary (unlike the other target areas, this has both a large number of derelict sites, and few noisy middle-class locals).

Secondly, the chancellor, Gordon Brown, wants to cool Britain's overheated housing market. A study to be published by the Treasury in the next few weeks will argue that housing shortages could slow economic growth. Its author, Kate Barker, a member of the Bank of England's Monetary Policy Committee, says that she has been taken aback by “the degree of resistance to planning applications.”

Despite this, Mr Prescott's plans are in trouble. New towns need good transport links. Sir Sandy Bruce-Lockhart, chairman of Kent County Council, warns that without guarantees of government cash for that,

the plans will be strongly opposed. Yet there is no sign that the deputy prime minister is anywhere near getting the money for this. His relations with colleagues in the Department of Transport are tense. The budget there is already under great pressure for other more popular causes.

So one bit of government wants to build new towns. Another bit is refusing to stump up the investment to make it practical. That stand-off results from the disbanding of the former Department of the Environment, Transport and the Regions after the 2001 election. Andrew Bennett, chairman of the parliamentary committee that monitors the deputy prime minister's department, says that regional policy is in a mess. Even Mr Prescott, a super-loyalist, says that splitting his old department was a mistake.

From that weak position, the deputy prime minister must fight off his critics. These include the predictable, such as the Council for the Preservation of Rural England, as well as those closer to home: a parliamentary committee dominated by Labour MPs has condemned the government's plans as unrealistic and environmentally unsustainable.

The most wounding criticism has come, however, from Lord Rogers, an architect involved in the government's urban task force. He says ministers should be seeking to reduce housing pressures in the south-east, not reinforce them. This last criticism stings. “What's he talking about?” barks Mr Prescott. “Is he really saying that we shouldn't build more houses in the south-east because there are a lot of empty houses in Hull?”

Quite possibly yes. Imposing vast new housing developments on reluctant local councils, rather than dealing with the underlying economic imbalances, may look an attractive quick fix. But the charge that the government is concreting over the south while bulldozing the north has a lot of weight. Central government often thinks it knows best when it comes to planning. History suggests it doesn't.

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Television

Switched over

Oct 9th 2003
From The Economist print edition

Will shareholders have the guts to change ITV's management?

THINGS could hardly be going better for Charles Allen and Michael Green, the bosses of Granada and Carlton, the two companies that own most of ITV, Britain's biggest commercial broadcast television network. This week they heard from Patricia Hewitt, secretary of state for trade and industry, that they can merge—the biggest shake-up in Britain's commercial television history. Best of all, they will not have to divest their advertising sales houses.

Most people expected the Competition Commission to demand this; a united ITV, after all, would control over half of Britain's television advertising market. Instead it recommended a gentler remedy: ITV will be prevented from raising its prices to advertisers for a minimum of three years. Investors were delighted.

By merging all of their operations, Carlton and Granada will get at least £55m a year in cost savings, which will help boost ITV's programming budget. That might stop the channel losing viewers at the steady rate it has done for the last 20 years. But many institutional shareholders believe that Mr Allen and Mr Green are not the men to revive ITV. The memory of the £1 billion they lost on ITV Digital, a new joint service that was switched off last year, is still painful. Few believe that the planned management structure for ITV, with Mr Allen as chief executive and Mr Green as chairman, will work; despite the hugging they did for the cameras this week, they do not get along.

Now that the merger has been given the go-ahead, disgruntled investors are likely to go to the non-executive directors of the combined company and demand a change of management. Much will depend on who those directors are. If the two tycoons manage to appoint feeble non-execs in the coming weeks, says Paul Reynolds, a media analyst at Deutsche Bank, investors will be furious.

In the long run ITV's future is likely to involve a foreign bidder. Keeping its advertising sales houses makes it more attractive. Haim Saban, the media mogul who bought Germany's ProSiebenSat.1 this summer, said last month that he wanted to buy ITV but not without its sales houses.

But the Competition Commission's conditions on the new company, albeit softer than expected, will make life tougher both for ITV now and for a prospective buyer. In the past, when ITV lost viewing share, it maintained advertising revenues by increasing prices. Now, when it loses its share of viewers' eyeballs, it will lose revenue to the same extent.

Mr Saban bluntly called ITV a declining asset, referring to the fact that it has been shedding viewers for years. How much difference will the merger make? Although the united company will have more money to put into programmes than any commercial broadcaster in Europe, the BBC, with £2.4 billion last year, easily trumps it. Multi-channel television, led by Sky, Rupert Murdoch's company, is growing, and ITV does not have a credible multi-channel strategy. Remaining public-service obligations imposed by the law, and weaker finances, risk leaving ITV as a weaker version of the BBC. If the network is not simply to be milked for cash on the way down, its best chance is that a change comes from outside.

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Bagehot

Nice(ish) policies, shame about the leader

Oct 9th 2003
From The Economist print edition

The Tory party is showing signs of life. That could be bad news for Iain Duncan Smith

THERE have been two Conservative Party conferences in Blackpool this week: the well-drilled official one in the ballroom of the Winter Gardens; and the unofficial, subversive one that has been rolling through the fringe meetings and the bars.

The official conference has done what it set out to do. The enormous stage successfully concealed the shrinking attendance that has accompanied electoral defeat and the grim reaper's annual toll of a membership whose average age is over 65. And while the shadow cabinet is these days devoid of stirring platform speakers, a more or less coherent theme did emerge.

The thanks for that should go, in part, to a rather good eve-of-conference pamphlet, called “Total Politics: Labour's Command State”. Produced under the guiding hand of David Davis, the shadow deputy prime minister, it is a telling critique of the government's addiction to centrally-imposed targets and the burgeoning Whitehall bureaucracy required to police them. As well as making the case against Labour's “state centralism”, it also outlines a new approach to public services, based on devolving power both to users and to frontline providers.

On cue, Damian Green and Liam Fox, respectively spokesmen on education and health, presented plans for giving parents and patients “passports” (vouchers by any other name) to buy services from competing schools and hospitals freed from the dead hand of central control. On law and order, Oliver Letwin talked of ending the home secretary's powers over local police forces, putting them instead under “the direct, democratic control of local people”.

Unfortunately, some of the other policies on show in Blackpool owed more to naked populism than intellectual coherence. How can a party that wants to curb the state and encourage personal responsibility object to university tuition fees and the stimulation of a competitive market in higher education? Similarly, the proposal to restore the earnings link to the state pension, while getting rid of credits aimed at the poorest pensioners, is potentially both expensive and inefficient.

Given the current dire state of the Conservative Party, it may make some sense to bribe middle-class interest groups, even at the price of broader credibility. But what made no sense at all was for Iain Duncan Smith, the Conservative leader, to start promising tax cuts. However much the Tories insist that their big-ticket promises can be funded by savings made elsewhere—step forward that hackneyed favourite, cuts in bureaucracy and waste—all the opinion-poll evidence suggests that such claims only increase swing voters' scepticism. What people seem to want is better value from their existing taxes.

As Mr Letwin shrewdly put it: “It's important that Labour can't describe our policies as ‘slash and burn.' ” Most people are prepared, at the back of their minds, to believe that over time taxes are likely to be higher under Labour than the Tories. But by talking prematurely about tax cuts, Mr Duncan Smith is only giving ammunition to Tony Blair and confusing what should be his party's most important message: that the Conservatives' newfound decentralist approach is superior to the philosophically flawed command-and-control methods of the government. That muddle suggests a lack of strategic grip at the top.

Such a criticism is kind compared with most of the things being said about Mr Duncan Smith this week. The parallel conference has been almost exclusively concerned with his inadequacies. Paradoxically, the government's difficulties over Iraq and public-service delivery, combined with the first stirrings of intellectual energy in the Conservative Party since Thatcherism's high-water mark in the late 1980s, have worked against him. Sullen resignation has given way to intense frustration. The party's lack of progress in the polls is now explained almost entirely in terms of Mr Duncan Smith's leadership. There may be

Tories who are convinced he is admirably suitable for the job and that the voters will come to recognise his qualities. But if so, they are keeping strangely silent about it.

Thickening plots

Gossip about plots to unseat Mr Duncan Smith has swirled with the intensity of the gale blowing down the promenade. According to one theory, as early as next week a deputation of senior figures will inform him that unless he resigns with dignity a formal leadership challenge is inevitable. According to another, the names of dissident MPs are being gathered and will soon be sent to Sir Michael Spicer, the chairman of the backbench 1922 Committee. If there are 25 of them—and current rumour has it that the plotters are only a couple short—party rules dictate a vote of confidence that Mr Duncan Smith would humiliatingly lose. Nor is it just MPs afraid for their seats who want him to go. Now it seems even the loyalty of the activists—the people who elected him only two years ago—is exhausted.

There remain two problems for those hoping to unseat the hapless Mr Duncan Smith. The first is that time is running out. Unless the deed is done by Christmas, it may be too late because the countdown to the next general election will then commence. The defiant speech that Mr Duncan Smith made on Thursday may win him a little breathing space. The second is the lack of a unifying alternative. Mr Davis, Mr Letwin and, the shadow chancellor, Michael Howard, all have their admirers. But each has drawbacks: Mr Davis is able, but not trusted; Mr Howard is combative, but has too much the whiff of the much-disliked last Tory government; Mr Letwin is clever, but lacks experience and radiates an other-worldly niceness that can be disconcerting.

It is Mr Letwin, however, who may be gaining momentum at the right time. This week, Bagehot detected in Mr Letwin a new hardness, even, perish the thought, a degree of nastiness. He is the coming man.

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Beyond the bubble

Oct 9th 2003
From The Economist print edition

After its spectacular crash, the telecoms industry is still picking itself off the floor. But provided it can adjust to less dizzying expectations, the business still offers plenty of opportunities, says Tom Standage

IT ALL started with a ball hoisted up a flagpole. International telecommunications began in 1801, when the first link was established between the optical telegraph systems of Sweden and Denmark. Both networks consisted of lines of towers, each with a set of moveable panels on top. By replicating the configuration of panels at the next tower along the line, it was possible to transmit messages over great distances with unprecedented speed. Such were the military benefits of this technology that a telecoms boom ensued.

Faced with the threat of an attack by the British fleet under Admiral Nelson, Sweden and Denmark had linked their telegraph networks to give them early warning. When Nelson attacked Copenhagen on April 2nd 1801, the news was transmitted to Sweden using the first ever network-to-network (or “internet”) protocol. The panels on the Danish telegraph tower at Kronborg were configured to indicate that Copenhagen had been attacked. Across the Oresund strait, the Swedes hoisted a flag to show that they had received the message. The system worked flawlessly—except that the Swedes did nothing to aid Denmark, and the Danish fleet was defeated. Not for the last time, the expectations raised by international telecommunications were disappointed.

Two centuries on, the towers, panels and flagpoles have been replaced by an international web of fibre-optic links, undersea cables, powerful routing and switching computers, mobile-phone basestations, and a plethora of telephones, computers and other devices, both wired and wireless. Industry revenues have steadily increased to reach an all-time high of $1.37 trillion this year, according to the International Telecommunication Union (ITU). There are 1.2 billion fixed telephone lines, and 1.3 billion people carry mobile phones of decreasing size and increasing complexity. Around 665m people now have access to the internet. Consumer spending on communications is growing faster than spending in any other category. Surely that makes telecoms a vibrant and successful industry?

The paradox of telecoms

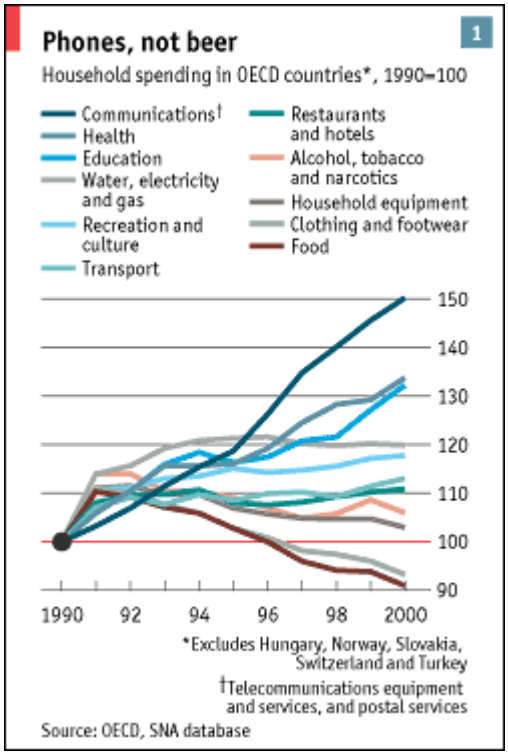
It does not. Despite all these apparently healthy signs, over the past couple of years the industry has become notorious for fraud, bankruptcy, debt and destruction of shareholder value. Exactly how much

money has gone down the telecoms drain is hard to quantify, but many estimates hover around the $1 trillion mark. Dozens of firms have gone bankrupt, including Global Crossing, 360networks, Williams Communications, Viatel and WorldCom, whose bankruptcy last year was the biggest ever. Hundreds of thousands of workers in the industry, and particularly at telecoms-equipment makers, have lost their jobs. What explains this paradox of an industry in chaos amid strong demand, growing traffic and record revenues?

The short answer is that although the industry has continued to grow, it has not done so in the manner, and above all not to the extent, that those in the industry expected. Telecoms is an infrastructure-intensive business, and because infrastructure takes a long time to build, telecoms firms have to make bets on the level and nature of future demand. As it turned out, the bets made during the technology bubble of the late 1990s were spectacularly wide of the mark.

In particular, the mania that accompanied the rise of the internet persuaded many investors that demand for data-network backbone capacity, to pipe internet traffic across continents, was about to explode. Since 1997, internet traffic has roughly doubled every year. Much of the industry, however, was convinced that traffic was doubling every 100 days. This widely quoted statistic, which originated at WorldCom, became an essential ingredient of business plans and conference presentations during the bubble. It assumed unimpeachable status when it appeared in a report published by America's Department of Commerce in April 1998. Dozens of firms rushed to build new fibre-optic networks in America, Europe and Asia. But apart from a brief period in 1995-96, the figure was simply wrong.

As upstart firms splurged on vast infrastructure investments, the incumbents in many countries tried to transform themselves into global operators. They expanded their existing networks and bought stakes in foreign operators, running up debts in the process. Meanwhile, European firms gambled that the expected surge in demand for fixed-communications capacity would be accompanied by a similar leap in demand for mobile capacity, and paid *euro*109 billion ($125 billion) for licences to operate “third-generation” (3G) mobile networks. They, too, took on a huge pile of debts.



But the expected deluge of data never came. In the four years from the beginning of 1998, says Andrew Odlyzko, a telecoms guru at the University of Minnesota, the amount of fibre in the ground increased fivefold. Meanwhile, advances in the technology of feeding signals into fibres at one end and extracting them at the other increased the transmission capacity of each strand of fibre 100-fold, so total transmission capacity increased 500-fold. But over the same period demand for transmission capacity merely quadrupled, a rise that could easily be accommodated by existing networks. Meanwhile, though, a dozen new national fibre backbones had been constructed in America, with a similar proliferation in western Europe. Mr Odlyzko estimates that around $150 billion was spent building unnecessary telecoms networks in America and another $50 billion in other parts of the world.

When it became clear that the predicted explosion of demand was not going to happen, operators frantically cut their prices, hoping to fill their empty pipes. Equipment-makers' sales collapsed and their share prices tumbled. Nortel, a once high-flying maker of telecoms gear, saw its market capitalisation fall from around $400 billion in the summer of 2000 to just $3 billion two years later. Some firms began fiddling their accounts to conceal the lack of revenue. Companies such as Global Crossing and Qwest resorted to “hollow swaps” and other dubious tricks to boost sales and traffic figures. In the most notorious case, WorldCom set a new record for accounting fraud, misclassifying capital expenditure as operating costs and overstating profits by $11 billion. When it was found out, it crashed spectacularly.

Now what?

The telecoms boom and bust, and the many colourful and crooked characters who lined their pockets on the way, produced a crop of books, the most entertaining of which is “Broadbandits: Inside the $750 billion Telecom Heist” by Om Malik, formerly a writer at *Red Herring*, a now-defunct technology

magazine. The aim of this survey, however, is not to look back but forward: to examine how the telecoms industry is extracting itself from its current mess, and what it might do next.

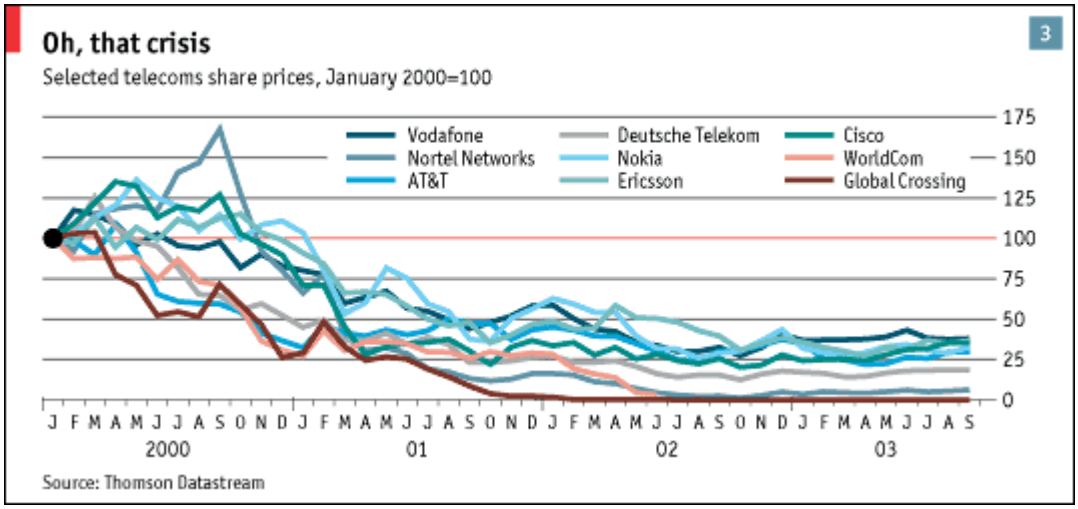
For the past couple of years, telecoms operators have concentrated on restructuring debt, cutting costs, retrenching in their home markets, backing out of bad investments, cleaning up balance sheets and trying to hold on to their customers. New management has been installed almost everywhere. But although operators may have done a good job cutting costs, notes Mark Winther of IDC, a market-research firm, they cannot save their way to success. “Less is not a strategy—it's a remedy,” says Ben Verwaayen, chief executive of BT, Britain's incumbent telecoms operator.

As the industry gathers in Geneva this week for ITU Telecom World, an industry bash that takes place every four years, the mood will be much more subdued than at the last get-together in 1999. But at least things have stopped getting worse. “This ITU comes maybe at the end of the worst part of the storm, but I'm not entirely sure we can be too excited about the future,” says Francesco Caio, an industry veteran who recently took over as chief executive of Cable & Wireless, a struggling multinational network operator. “The industry has entered a new phase that is much more a maturity phase than a growth phase.” Industry-wide double-digit growth has gone, he says, probably forever. “So where do the opportunities lie going forward? That's really the challenge for us all.”

The post-bubble opportunities seem to lie in exploiting three main trends. The most visible growth area is the continuing rise of mobile phones, which have overtaken fixed-line phones to become the most widespread communications devices on earth. Their number is expected to rise from 1.3 billion today to 2 billion by 2007, and they are being increasingly used to do much more than make phone calls, providing new opportunities for wireless operators and equipment makers.

The second trend is the growth of high-speed or “broadband” internet access, which is booming in many parts of the world. This offers a valuable new market for fixed-line operators, once they have supercharged their existing telephone networks to make them broadband-capable.

A third promising area is in the corporate-telecoms market. As large firms look for ways to cut costs and move operations overseas, many are adopting new internet-based technologies that can interconnect regional offices cheaply and securely and allow voice and data to flow over the same network. Many operators are now overhauling and simplifying their tangled networks to ensure they can implement such “next-generation services” quickly and efficiently.



But all three areas involve difficult transitions for telecoms operators. The continued health of the mobile-telephony industry depends on being able to deliver data services alongside voice calls, revenues from which are flat or declining. Creating and delivering multimedia services to mobile handsets is, however, proving to be a lot more complicated than simply providing telephony. Similarly, fixed-line operators

offering broadband internet connections are having to work harder to provide both data and voice services than voice services alone. And in the corporate market the operators face a new challenge: the increasing overlap between telecoms and information technology (IT). If they are to offer next-generation services such as internet hosting or call-centre outsourcing, network operators must beef up their expertise in IT or form partnerships with systems integrators.

Equipment vendors also face a wrenching transition. Mobile, broadband and next-generation services require new equipment on the edges of telecoms networks, rather than more capacity in the network core, which is where so much unnecessary investment was made during the bubble. This has completely changed infrastructure spending patterns, and equipment vendors have had to adjust.

In short, there are still opportunities in telecoms—but not where they were during the boom. The experience of the past couple of years, says Dave Dorman, chief executive of AT&T, has demonstrated that there is more to being a telecoms operator than simply owning a shiny new network. The best prospects are at the network's edges, not at its core, and revolve around providing complex services, not merely dumb capacity. The watchword now is transformation, not construction. Only by embracing this new reality will the industry find a way out of its troubles.

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Not just talk?

Oct 9th 2003
From The Economist print edition

Wireless-telecoms firms are finding data services a hard sell—except for text

ONLY 20 years ago, there was little reason to think that mobile phones were about to become the most popular communications devices on the planet. The state-of-the-art kit in 1982 was the Mobira Senator, just launched by an obscure Finnish company called Nokia. It consisted of a small handset tethered to a large black brick, its battery. The whole thing weighed 9.8kg, or about 100 times as much as a modern mobile phone. Fortunately it had a chunky carrying handle.

A mere two decades later, in 2002, the number of mobile phones overtook the number of fixed-line ones. With mobile phones in use around the world already numbering about 1.3 billion, some 450m new handsets are still being bought every year (most people upgrade their handsets every couple of years). Globally, one person in five now has a mobile phone; in parts of Europe and Asia, where mobiles are most popular, around 80% of the population—or pretty well everyone between the ages of 10 and 80—carries one. America is a laggard, with mobile-phone penetration at around 50%, but it is catching up. Nokia has become the world's largest handset maker, with nearly 40% of the market. Today's most advanced mobile phones are tiny, lightweight devices that run for up to a week between battery charges. They are, in effect, pocket computers, and include all kinds of whizzy new features such as still and video cameras, colour screens, internet access and games.

Mobile telephony is growing fastest in the developing world, where many people's first phone is a mobile. Wireless networks can be established more quickly and cheaply than wired ones, because there is no need to run a wire into every subscriber's home. Mobile phones are booming in China, which now has more than 200m subscribers—a larger number than any other country—and is adding new ones at the rate of 5m a month. But mobile penetration is still low, at only 18%, so this growth will continue for the rest of the decade. There is also vast scope for growth in India, where penetration is just 1% but mobile phones are at last taking off. According to Telecompetition, a market-research firm, China and India will account for 60% of new mobile subscribers between now and 2010.

Another booming region is central and eastern Europe, where mobile telephony provides a way to bypass creaking fixed-line infrastructure from the Soviet era. Once a mobile network is up and running, all that subscribers have to do is buy a handset. And in the world's least developed regions, such as sub-Saharan Africa, mobile phones have at last pushed the number of phones per 100 population (known as teledensity) above one for the first time. Pre-paid cards, which do away with the need for credit checks, and the sharing of handsets among many users have brought telephony within almost universal reach.

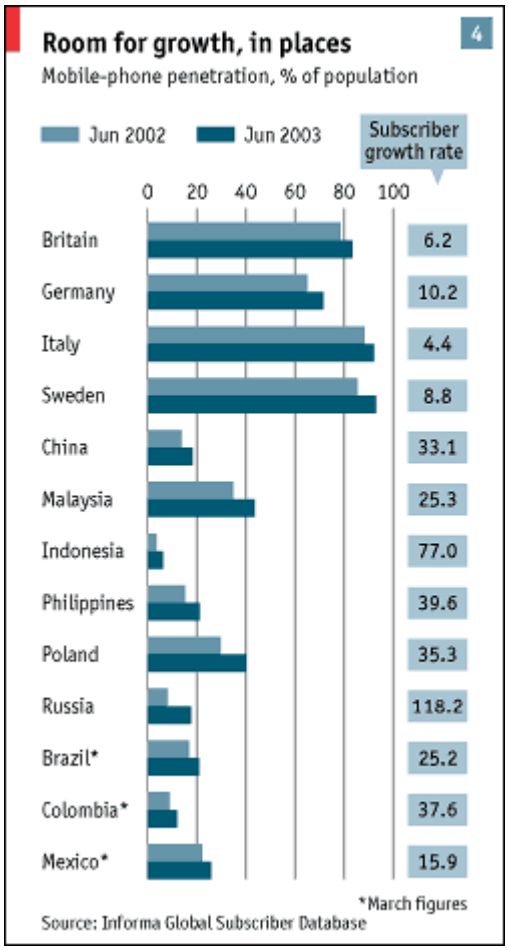
But the mobile-phone industry cannot rely on subscriber growth forever. Eventually everyone who wants a mobile phone will have one, as has already happened in parts of Europe and Asia, at which point a new source of growth will be needed. The industry reckons that the most promising source will be delivering data to handsets alongside voice. “Unless we are able to cultivate and grow data traffic, we cannot guarantee further growth for the mobile communications industry,” says Keiji Tachikawa, president and chief executive of NTT DoCoMo, Japan's largest mobile operator and the world leader in mobile data services. In the most developed mobile markets, the introduction of such data services is well under way. But it has been a painful and difficult process.

A catalogue of errors

The trouble began with Wireless Access Protocol (WAP), a crude and cut-down form of web-browsing

designed for mobile phones, which was introduced by operators worldwide from 1999. In a blatant attempt to cash in on the dotcom mania of the time, WAP was described as a mobile version of the internet, when in fact it was nothing of the sort. Establishing a connection on a WAP phone and downloading any of the limited content available took far too long, and mobile handsets had tiny monochrome screens, which further heightened users' frustration. No wonder WAP was a flop.

Yet the industry went on making the same mistake, promoting technologies rather than creating useful services using those technologies. In 2000, this obsession with whizzy technology caused Europe's mobile-phone industry to get carried away in the bidding for licences to operate third-generation (3G) mobile networks, which can support higher voice capacity and faster data downloads than existing 2G networks. European operators agreed to pay a total of *euro*109 billion ($125 billion) for 3G licences. An extract from an ITU document dated October 2000 gives a sense of the hype surrounding 3G at the time:



> The 3G device will function as a phone, a computer, a television, a pager, a videoconferencing centre, a newspaper, a diary and even a credit card...it will support not only voice communications but also real-time video and full-scale multimedia...It will also function as a portable address book and agenda, containing all the information about meetings and contacts...It will automatically search the internet for relevant news and information on pre-selected subjects, book your next holiday for you online and download a bedtime story for your child, complete with moving pictures. It will even be able to pay for goods when you shop via wireless electronic funds transfer. In short, the new mobile handset will become the single, indispensable “life tool”, carried everywhere by everyone, just like a wallet or purse is today.

Never mind whether people actually wanted to do any of these things with their mobile phones; the technology would make it possible, and its adoption by potential users would somehow miraculously follow. This was the same “build it and they will come” mentality that led fixed-line operators to spend hundreds of billions of dollars building networks for which there was no demand.

It soon became clear that paying so much for 3G licences had been a huge mistake. As their share prices collapsed, mobile operators wrote down the value of their 3G licences. Some even handed the licences back to the governments from which they had bought them, rather than commit themselves to building expensive new 3G networks.

The licences require operators to build networks within strict time limits, and to use a particular technology, called W-CDMA. But this untested technology has been beset by teething troubles. The W-CDMA specifications contain a lot of options, explains Anssi Vanjoki, vice-president of Nokia's handset division, and different vendors have gone down different routes. The only operator to have launched a commercial 3G service in Europe so far is Hutchison 3G, known as 3, which is already up and running in Britain, Italy and Sweden, and is going ahead in Australia, Austria, Denmark, Hong Kong, Ireland and Israel. However, anecdotal evidence from 3 subscribers suggests that technological gremlins remain.

Textbook stuff

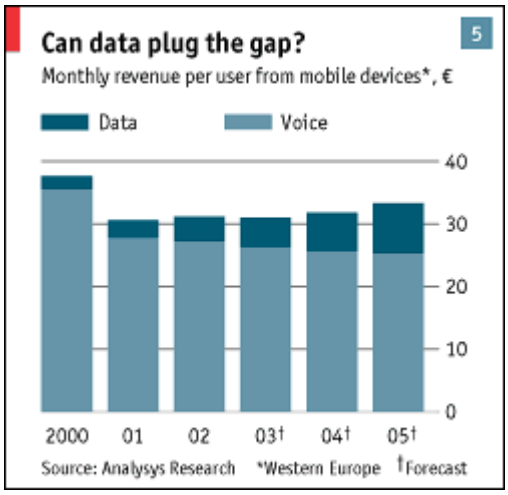
But whereas 3G has so far proved an expensive mistake, text-messaging has been a spectacular success, showing that consumers are prepared to use their phones for more than just voice calls after all. Texting took off unexpectedly, without any marketing by operators, but it has now become a core part of their businesses. For users, the appeal of texting is that it is a simple, quick and unobtrusive way to send someone a message, usually for less than the cost of a voice call. Texting first took off among cost-conscious teenagers. More than one billion text messages are now sent every day around the world, at an average cost of around 10 cents. Ringtones and screen logos can also be delivered by text message,

but cost more. All these messages add up to a huge industry that generates about $40 billion a year.

The average mobile-phone subscriber sends 30 messages a month, though in some countries the figure is far higher (250 messages a month in Singapore) and in others lower (seven messages a month in America). America's lack of enthusiasm for texting is due to a number of factors, including incompatibility among different networks, whereas in Europe regulators have insisted on a single common standard. But the main reason why Americans text less is that most of them get free local calls on fixed-line networks. This has forced mobile operators to offer huge “buckets” of off-peak minutes as part of their tariffs—sometimes as many as 5,000 per month—to encourage subscribers to use their mobile phones rather than fixed-line ones. That means it is usually cheaper to call than to send a text message.

Outside America, the success of texting has been a godsend for operators. Text messages, which are limited to 160 characters in length, require minuscule amounts of network capacity and are hugely lucrative. Text-messaging now accounts for 20% of some operators' revenues, a windfall that has helped to make up for declining revenues from voice calls.

There are now promising signs that mobile operators have learned from the failure of WAP and the success of texting. The industry has devised a new plan to encourage customers to adopt data services and thus, it hopes, make a smooth and unobtrusive transition to 3G. The idea of introducing 3G with a big bang is out; most subscribers will not even know when they move over from today's enhanced 2G, or 2.5G,networks.



The breakthrough is that operators are now talking about services, not technology, says Ben Wood, an analyst at Gartner, a consultancy. “We need to see things from the point of view of the customer rather than the supplier,” says Julian Horn-Smith, chief operating officer at Vodafone, the world's biggest mobile operator. “What are the services customers would like to have and use on their mobile devices? Frankly, which kind of technology is driving those services is of secondary interest.” This service-based approach was pioneered by NTT DoCoMo with its i-mode service, and was immediately copied by Japan's other two operators. It has since been imitated around the world, notably by Vodafone, with its live! service, which has attracted more than 2m subscribers since its launch a year ago. T-Mobile has a similar service called t-zones, O2's is called Active, and in America Sprint's service is called Vision.

The basic idea is the same for all of them: subscribers get a fancy handset with a large colour screen and usually a built-in camera. The phone is pre-configured with menus and bookmarks offered only by that particular operator, making it easy to download games and access news and other information. As well as being able to send and receive text messages, subscribers with camera phones can also swap photos. All of these services are bundled together for a monthly fee. Crucially, all of them work “out of the box”, without the user having to set up anything.

Gone are the days when the industry wondered about the single “killer application” that would persuade users to adopt mobile data. Instead, says Mr Horn-Smith, “it's a cocktail of applications.” Vodafone's market research correctly predicted that people would be attracted to the bundle of services by photo-messaging, but would end up using it less than they expected to, and would instead spend money on downloading games and ringtones. The big question is whether they end up spending more overall. Early signs are promising. Live! subscribers' monthly phone bills are, on average, 7-10% higher than those of other users. These could just be tech-savvy early adopters, but if they are representative of the wider public, “that's very satisfactory,” says Mr Horn-Smith.

Evidence of growing enthusiasm for data services also comes from the regular Mobinet survey of 5,600 mobile users in 15 countries, carried out by A.T. Kearney, a consultancy, and the Judge Institute of Management at Cambridge University. The latest survey found that 43% of users now have an internet or WAP-enabled phone, and 34% have accessed internet content on their phones, up from 27% in June 2002. A quarter of users worldwide now have phones with colour screens. And the number of people downloading and playing games on their phones has doubled over the past year to 6% of all users, with even higher levels in America (10% of users) and Brazil (15%).

Once data services are running well on 2.5G networks, the operators will then gently move users over to

3G networks, which will offer improved speed and capacity, making new services possible. This will be done using dual-mode handsets that can switch smoothly between 2.5G and 3G networks. “If I am receiving ringtone downloads or games, I won't be aware whether it's by 2.5G or 3G,” says Mr Horn-Smith. “When somebody calls you, you won't care which technology you are speaking over. 3G is about capacity and speed, but it isn't a service in itself, it's just an enabler of services, so we won't market 3G per se.” That is quite a change from the hype of three years ago.

In Japan, which has led the way with both data services and the introduction of 3G, Mr Tachikawa is already looking ahead for new sources of growth once 3G data services have become commonplace. He is particularly optimistic about the potential for machine-to-machine communication over mobile networks. “PCs, cars, home appliances—all could be attached to wireless capability,” he says. DoCoMo estimates that the number of devices in Japan which might be linked in this way exceeds the human population by a factor of five.

But if data services fail to take off, there is a fall-back plan for 3G: good old-fashioned voice calls, which can be carried more cheaply on 3G networks than on 2G ones. There is plenty of potential left in mobile voice traffic, notes Paul Lee of Deloitte Consulting. Mobile calls tend to be shorter than fixed ones, and the total number of voice minutes carried is lower for mobile than for fixed phones. “There is still scope for mobile voice to increase both volumes and revenues,” he says. Mobile operators could use excess voice capacity on their 3G networks to shift more voice traffic from fixed to mobile phones. It would be quite a comedown for a technology that once inspired such high hopes, but anything is better than nothing.

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Between a rock and a hard place

Oct 9th 2003
From The Economist print edition

With their core voice businesses in decline, incumbent fixed-line operators are shifting to broadband

IT IS hard to get excited about fixed-line phones. You plug them in, you dial a number, you get through, so what's new? But Vonage, a small company based in Edison, New Jersey, has rustled up some magic with its breathtakingly clever phone technology. It makes you realise just how limited existing fixed-line phones are, and how much internet technology can do to shake up the business of providing boring old telephony.

Vonage's phone service provides unlimited calls within the United States and Canada for $34.99 a month. Subscribers plug a standard phone into a small black box called an analogue telephone adaptor (ATA) and then plug the ATA into their existing broadband internet connection. When they pick up the phone, they hear a normal dialling tone (which is faked by the ATA). If they dial a number, they are connected in the normal way. If someone dials their number, their phone rings. So far, so normal. The difference is that their calls are being routed across the internet, which is why Vonage can offer such low prices.

Now things start to get more interesting. Because the phone is plugged into the internet, it can be anywhere. So you can take your phone and ATA (with, say, a New York 212 area code) to Europe or Asia and plug it into the broadband connection in your hotel room. Everything still works: people dialling your number from New York are still charged for a local call, and you can continue to call people just as if you were back in New York. For an extra $5 per month, you can associate a second phone number with the phone, perhaps with a different area code. Another feature allows a subscriber to plug in lots of phones in different parts of the world, all of which ring when that subscriber's number is dialled.

Mobile phones have already introduced the idea of a phone that works around the world. But the Vonage model is even more disruptive, further undermining the connection between specific area codes and particular places. The company is expected to introduce a new tariff soon that includes unlimited calls to western Europe. After that, why not unlimited phone calls to anywhere, for a flat monthly fee? The logical conclusion of the Vonage model is the demise of distance- and time-based charges, with telephony becoming an internet-based subscription service.

That is not to say that Vonage is about to conquer the world. It is a tiny company, with a mere 50,000 customers. John Rego, Vonage's chief financial officer, says his firm is aiming for 100,000 customers by the end of the year, with the help of partnerships with internet-access providers and cable operators, who are reselling Vonage's service in conjunction with broadband internet service.

For the incumbent telecoms operators, though, what is scary about Vonage is not the company itself but the disruptiveness of its model. Vonage is a telecoms company with the agility of a dotcom. Everyone in the telecoms industry has heard of it, and has wondered what will happen if the model is widely adopted. “We're having fun, but the incumbent folks have issues to deal with,” says Mr Rego gleefully.

Line decline

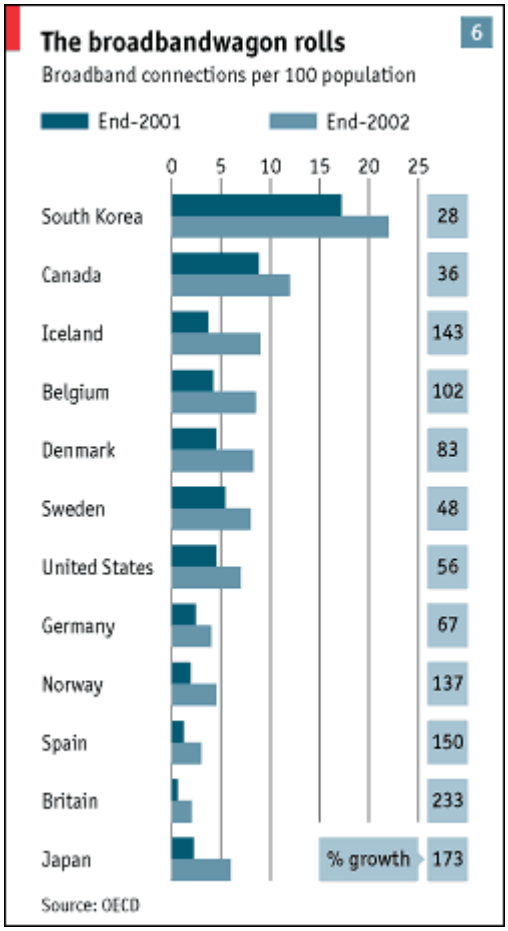
That is putting it mildly. And the threat of internet-based telephony is just one of the many problems facing incumbent telecoms operators around the world, most of which are partly or wholly privatised former national monopolies. They own the copper-wire network that runs into their subscribers' homes, and have strong cash flows thanks to the monthly or quarterly standing charges paid by subscribers. But their businesses are in decline.

Their main problem at the moment is the rise of mobile phones, which are eating away at the incumbents' core business of fixed-line voice telephony. Such “fixed-to-mobile substitution” means

people are making fewer calls on their land lines, and are doing away with second lines, thus reducing operators' revenues. European incumbents' fixed-line voice revenues are expected to decline by 2.5% this year, according to J.P. Morgan, an investment bank. In some countries the drop may be as much as 12%. In America, the incumbents (the former Baby Bells) are watching fixed-line voice revenues decline by 7% a year. This is likely to get worse with wireless number portability, which will soon let American subscribers transfer their fixed-line numbers to mobile phones.

Fixed-to-mobile substitution has gone furthest in mobile-crazy Finland, where the number of households with fixed-line phones has been falling since 1990, when it peaked at 94%. Nearly one in three Finnish households is now without a fixed-line phone. Switching to mobiles is easy in Finland, where wireless coverage is very good and users expect to be able to get a signal even in the most remote areas. But it is happening elsewhere too: 6% of British households, for instance, have already given up their fixed-line phones.

Incumbents are also losing subscribers to competing fixed-line operators. Regulations in most countries require incumbents to lease lines to other operators at low rates, to allow them to offer telephone services and introduce competition into the market without having to dig up roads and lay new phone wires. America's incumbents have so far lost 10% of their customers to competing operators in this way. In some countries, cable operators are also offering telephony services and are wooing customers away from incumbents. The most technically savvy cable operators offer subscribers a seductive “triple play” bundle of services for a monthly fee: telephone, broadband and cable TV.



Faced with competition from mobile on the one hand and fixed-line and cable operators on the other, as well as the longer-term threat of internet telephony, incumbents are fighting back in several ways. For a start, they are using new pricing structures, reducing their call charges and raising their monthly line-rental charges. This makes their call charges look more competitive but shores up their revenues even as call volumes decline. That way, says Laura Mills, an analyst at Merrill Lynch, “even if people use mobiles, you still get paid.” But by raising line-rental charges, she notes, incumbents risk prompting people to give up their fixed lines altogether.

Taking this approach to its logical conclusion, some operators are doing away with call charges altogether, instead offering unlimited local and national calls for a flat monthly fee. This trend is most prevalent in America at the moment, but is also in evidence in other parts of the world, such as Britain and Scandinavia. Again, some subscribers seem to prefer the simplicity and predictability of a fixed monthly charge, even though they may end up paying more as a result. “Consumers will pay a premium for the predictability of flat-rate,” says Vasa Babic of Mercer, a consultancy. Several American operators are now offering bundles that include local, national and wireless calling, and sometimes broadband internet access too. This summer, many operators struck resale deals with satellite-TV providers, adding TV to the mix.

But not everyone is convinced that such increasingly elaborate bundles make sense. Richard Klugman, an analyst at Jefferies, an investment bank, suggests that bundles are being driven solely by operators' desire to retain customers, rather than by actual consumer demand, which “makes it difficult to see these bundles as long-term solutions.” Joao Baptista of Mercer is also sceptical that stodgy telecoms firms can move into areas such as TV. “Companies are prisoners of their own DNA,” he says. “They find it hard to expand beyond their core services.”

In many European and Asian countries, the incumbent operator owns the largest mobile operator, and can therefore influence the rate of fixed-to-mobile substitution. France Telecom owns Orange, for example, and Deutsche Telekom owns T-Mobile, the largest mobile operators in France and Germany respectively. Once the stockmarket recovers, however, this could prove problematic. Floating their mobile arms would allow these two debt-laden incumbents to raise some much-needed money, but increased competition from mobile might then hasten the demise of their fixed-line businesses.

Regulation is another tool that incumbent operators have been using to defend their positions, notes Andrew Heaney of Spectrum, a consultancy. In most parts of the world, however, regulatory decisions are going against incumbent operators as regulators strive to increase competition—though newcomers complain that incumbents are still making it hard for them to gain access to their networks.

Just as their voice businesses have gone into apparently terminal decline, however, a new market has opened up for incumbent operators: broadband internet access. By installing special equipment at telephone exchanges, operators can supercharge old-fashioned telephone wires and turn them into fast broadband pipes, using digital subscriber line (DSL) technology. Subscribers in Europe and America typically pay around $50 a month for a DSL connection, so this provides a valuable new source of revenue for incumbents, which they are now racing to exploit. Around the world, DSL is booming and has become the dominant means of providing broadband access to homes and small businesses.

Until a couple of years ago, many operators soft-pedalled on DSL deployment or made it prohibitively expensive. This was usually because they were trying to protect other parts of their business, such as ISDN (an old-fashioned form of data transfer over telephone wires) or frame relay (an expensive way of providing always-on connections between two points), both of which cost far more than DSL. “Within telcos, you had different parts warring with each other over pricing, saying you're undercutting my product,” says Sam Paltridge, a broadband guru at the OECD. Regulations forcing incumbents to lease their facilities to competitors also discouraged some operators from investing in DSL equipment which they would then have to share with rivals.

Go for it

Eventually, however, incumbents decided that the benefits of embracing DSL outweighed the drawbacks. Many would-be competitors ran out of money and folded their tents. In some countries, cable operators began offering broadband access over their cable networks. Incumbents realised that if they did not cannibalise their own businesses, someone else would, and that in any case DSL would massively expand their market. Indeed, the technology can help to dissuade customers from giving up their landline telephones, since it piggybacks on an existing telephone line which can still be used to make calls.

Incumbent operators are now repositioning themselves as broadband operators. When Ben Verwaayen took over as chief executive of BT at the beginning of last year, he declared that broadband would be at the heart of BT's business. “The threat of DSL is to ignore it, to put your head in the sand,” he says. But embracing DSL requires incumbent fixed-line operators to do the same as mobile operators: to switch from a predominantly voice-based business to one in which voice and data are equal partners. That entails a learning process for operators and, as with mobile data services, it means pricing and marketing broadband to appeal to the widest possible audience.

Although broadband is growing fast, in most places this is not fast enough to offset the decline of voice, which accounts for 70-90% of most fixed-line operators' revenues. If they can move a significant proportion of their customers over to broadband, however, operators should be able to offer a range of new data services on top of it. “Operators are realising that broadband is going to be their future, and they need to migrate customers to it, but in a managed and controlled way,” says Michael Philpott of Ovum, a telecoms consultancy. To start with, that means careful control of pricing. Operators generally start with high prices, but once everything works smoothly, they bring them down to boost uptake.

Most operators in western Europe, says Mr Philpott, are pricing their broadband services to achieve 10% penetration, but that goal is still a long way off. To expand the market beyond that, as South Korea has done, requires a different approach in which operators provide different levels of service at different prices. Instead of the usual DSL data rate of around one megabit per second, they offer faster connections (up to 6 megabits per second) to high-end users at higher prices, and slower connections (down to 0.15 megabits per second) to bring in more subscribers at the bottom of the market. Several countries are also trying usage-based pricing, in which the monthly bill depends on how much is downloaded, but so far this has proved unpopular with users.

Tailor-made

Another innovative service, already available in some Scandinavian countries, allows DSL subscribers to boost their connection speeds for a limited period, for a small fee. “If someone is going to send you a large file, you might pay *euro*1 to boost your DSL rate for an hour or two,” says Mr Philpott. Mr

Verwaayen calls this concept “liquid bandwidth”. The idea, he says, is to be more responsive to customers.

Next, operators can start to offer different DSL services aimed at different types of user. Mr Philpott gives the example of QSC, a German DSL provider that offers specific DSL services for game-players, teleworkers and so on. On top of DSL, operators can sell extra features, just as on top of voice telephony they sell extras such as caller ID, call-waiting and voicemail. Teleworkers, for example, might be offered secure links to their offices. Home users could be offered firewalls, anti-virus services and parental-control software to prevent children from looking at the wrong websites. Some operators are even offering DSL-based video services, music downloads and online software stores. “We're more and more treating customers like members,” says John Polumbo, the boss of AT&T's consumer business, which has just launched a software-download service. “We have a great opportunity here, to become the conduit.”

This all sounds marvellous, but to get growth from DSL, incumbents will have to learn new tricks. They will have to become more data-savvy, form partnerships with content providers and market themselves in a different way. Mobile operators have been doing this for a while, and have made good progress in transforming themselves from stodgy utilities to vibrant consumer brands. Incumbent fixed-line operators must now follow in their footsteps. Broadband is the key to their future growth, but the transition will be hard to manage.

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Only a beginning

Oct 9th 2003
From The Economist print edition

Wi-Fi is useful, but in its present form it will not change the world

GIVEN that wireless and broadband technologies are two of the brightest spots in telecoms today, many people regard Wi-Fi, a wireless broadband technology, as a sure-fire winner. Intel, the world's largest chip maker, is spending $300m to promote its Centrino Wi-Fi chips under the banner “Unwire”. *Wired* magazine, the bible of Silicon Valley geeks, even renamed itself *Unwired* for a special issue devoted to the technology.

Setting up a Wi-Fi network involves plugging a small base-station into your broadband internet connection. Wi-Fi-enabled laptops within 50 metres can then connect to the internet wirelessly, via the base-station. Fervent Wi-Fi believers dream of blanketing cities with Wi-Fi coverage, making wireless high-speed internet access available to all. Some think it will turn the technology industry around by driving demand for broadband connections and boosting e-commerce and online-advertising revenues. Around the world, companies are rushing to build Wi-Fi hotspots in public places such as airports, conference centres and coffee shops to cater for laptop-toting travellers. Wi-Fi has, in short, inspired a mania not seen since the early days of the internet. Along with blogging (publishing an online diary), it is keeping the guttering flame of internet utopianism alive.

Wi-Fi is certainly useful, allowing people to use a laptop anywhere around the house, office or campus. But it does not amount to an epochal shift. Although there are perhaps 25m Wi-Fi enabled laptops around the world, not all that many people carry their laptops around all day. Operators are gambling that demand will pick up as they build more hotspots. But this is eerily reminiscent of the “build it and they will come” approach taken by many firms during the dotcom boom. The hotspot market shows all the signs of a bubble about to burst. Unless Wi-Fi is added to mobile phones, most people will not carry a Wi-Fi-capable device, so hotspots will have limited appeal. In short, Wi-Fi in its current form is not a mass-market phenomenon in the mobile-phones league.

The true significance of Wi-Fi is that it provides a glimpse of the potential of wide-area wireless-broadband technologies. A good example is the network jointly operated by Walker Wireless and Vodafone in Auckland, New Zealand. It uses technology from IPwireless, a company based in San Bruno, California, to deliver wireless broadband access, and also supports voice calls, routing them over the broadband connection.

The wider the better

Connecting a computer to the network involves plugging in a small wireless adaptor, as with Wi-Fi, but the service is available over a wide area, not just in small hotspots. The IPwireless base-stations are mounted on existing mobile-phone masts, covering the same sort of area as a standard mobile-phone base-station, or about 10,000 times larger than a Wi-Fi hotspot. Within the coverage area, the network competes with incumbent operators offering voice and broadband over copper telephone networks.

Other wireless-broadband firms, such as Flarion, Arraycomm and Navini, offer similar technology. Meanwhile, new versions of Wi-Fi for wide-area use are being developed. In a decade's time, people will look back at today's Wi-Fi as a transitional technology, a stepping stone on the way towards true wireless broadband.

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From pipes to services

Oct 9th 2003
From The Economist print edition

Telecoms and computing are converging

EVERYWHERE you look in telecoms, the emphasis is on data. Mobile operators are looking to data services to provide future growth. In the domestic fixed-line market, the incumbents are betting on broadband-internet services. In the corporate telecoms market, operators are betting on the provision of new kinds of data services to large companies as a promising source of future growth. Such services range from the relatively simple business of securely interconnecting a company's regional offices through a “virtual private network” to running entire networks, data centres or call centres.

Some operators will even design and implement new computer systems, write custom software and manage a company's computers, from mighty mainframes to humble desktops. This sort of systems-integration work is traditionally done by large information-technology (IT) firms such as IBM, EDS and Accenture. But as the overlap between telecoms and IT grows, some telecoms operators are getting in on the act too, trying to increase their margins and strengthen customer loyalty.

Just look at the history of telecoms, and you can see why this makes sense, argues Lee Hsien Yang, president and chief executive of SingTel, a large pan-Asian operator. In the 1970s and early 1980s, SingTel's business was based on telex and telegrams. Then the emphasis switched to long-distance telephony; and now SingTel makes most of its money from mobile telephony, which is booming in Asia. “You need to stay relevant,” says Mr Lee. Hence his firm's growing interest in providing advanced data services rather than mere connectivity. SingTel's systems-integration arm, NCS, has nearly tripled in size over the past five years.

Other network operators with high-powered services arms include AT&T in America, NTT in Japan, BT in Britain and Deutsche Telekom in Germany. Providing additional services requires more than just technical skills, says Andy Green, chief executive of BT's services arm. Operators also have to be careful to structure outsourcing deals properly and avoid getting locked into loss-making contracts. “IBM and EDS have a longer history in this business, but we are learning,” says Mr Green. “We've been doing this for 10 years, and the first four were not fun. We made some really silly contracts.”

Networking skills

There are services that network operators are particularly well placed to offer, such as back-up and disaster-recovery. Shuffling data to a secure location overnight, or switching from one data centre to another to keep a website online in a power failure, are heavily network-dependent activities. And as computing becomes ever more network-dependent, there are more opportunities for network operators to offer new data services.

Perhaps the best illustration of this convergence of telecoms and IT is the growing practice of carrying voice calls over corporate data networks, using voice-over-internet-protocol (VoIP) technology. This is the same technology that Vonage and other internet-telephony firms use to route calls across the public internet at low cost, by breaking up voice calls into packets of internet data. There are signs that VoIP is at last starting to take off within large companies as the technology matures and prices fall. In-Stat/MDR, a market-research firm, estimates that the proportion of American firms using VoIP will rise from 2% now to 19% by 2007. In July, Cisco, a network-equipment manufacturer, announced that it had shipped its two millionth VoIP telephone (a fancy phone that plugs into a data network rather than a phone network). Shipping the first million took three-and-a-half years; the second million sold in less than a year, in the midst of the telecoms meltdown.

What is the attraction? “It costs less, and you can do more with it,” says Mike Volpi of Cisco. Routing calls over the internet costs less than over conventional phone lines, and there are savings to be had in

replacing separate voice and data networks with a single network. Users can switch from one desk to another, or one office to another, by logging on at any phone. VoIP phones can be integrated with PCs, say, in a call centre, so that an incoming caller's records automatically appear on screen. Companies are not ripping out their old phone systems to buy VoIP technology, but they are using it to replace outdated gear, link up greenfield sites and establish temporary offices, says Margaret Hopkins of Analysys, a consultancy. All that is needed is a fast data link to the remote site.

Piping voice and data to a regional office along a single wire: is that telecoms or IT? It's hard to say. The interesting question is how far into IT territory telecoms operators should venture. Ms Hopkins identifies two camps. Some operators, she says, like to stick to network-related activities such as network management, inter-site connection and perhaps security services such as virus-scanning and network monitoring. They provide services that connect a company to the outside world, but keep out of the firm's own network. The more ambitious operators go much further, managing internal networks, computers and application software, and even maintaining employees' hand-held computers and home machines, as well as providing traditional telecoms services. In November last year, for example, BT signed a *euro*1 billion deal to manage voice, data and mobile communications for Unilever, a consumer-goods firm, replacing 200 suppliers in 180 countries.

Does this mean telecoms firms and systems integrators are at each other's throats? Not necessarily. A showdown between telecoms and IT firms has been predicted for many years, observes Francesco Caio of Cable & Wireless. After the break-up of AT&T in 1984, he notes, it was widely expected that IBM and AT&T would get involved in a two-way fight for domination of computing and telecoms as each tried to move on to the other's turf. But in practice, telecoms and IT firms have largely kept out of each other's way. “We think there is an opportunity to capture some growth by developing systems skills,” says Mr Caio of his own company. “But even today, IBM and AT&T, although working with a set of similar technologies, are still doing two different jobs.”

By and large, says Mr Volpi, customers are more likely to give a telecoms operator the lead role in a network-specific task (such as network management), but favour a systems integrator in a computing-specific task (such as setting up a customer-service website). Call centres are right on the boundary, because they involve both networking and computing components. In such cases, Mr Volpi explains, systems integrators often team up with operators, though the systems integrator usually takes the lead role. “There are significant parts of IT where the telcos will admit: ‘that's not our core strength',” says Colleen Arnold, IBM's telecoms supremo. When it comes to dealing with operators, she says, “sometimes we compete, and sometimes we collaborate.” Mr Lee of SingTel concurs: “We have a preferred partnership with our own systems-integration arm, but we will also work with a wide range of partners, including the usual major players.”

Indeed, as the telecoms industry matures, it is becoming increasingly reliant both on IT and on people from the IT business. “Bringing non-telecoms people into telecoms is the thing to do,” says Mr Heaney of Spectrum. He thinks that network operators offering complex services should emulate systems integrators such as IBM. Just as the computer industry has shifted from selling boxes to selling a complete package of software, hardware and systems integration, collectively known by that dread word “solution”, so telecoms firms must follow suit. In IT, the ability to win big contracts, says Mr Heaney, “is much more based on being able to sit down with the customers, understand what they want, pull in the right partners, and be responsive when things go wrong. That's what telecoms firms have to do.”

Converging, not competing

As well as bringing expertise, IT people are helping to put the telecoms house in order. The scandals that emerged after the bursting of the telecoms bubble prompted telecoms firms to look outside the industry for corporate leaders who were not tainted, and the IT industry was the obvious place to look, says Rae Sedel of Russell Reynolds Associates, a global headhunting firm. Both industries, she observes, involve dealing with big corporate clients, complicated sales and complex, fast-changing technology. From the 1930s to the 1970s, the telecom-equipment industry hardly changed; from the 1970s to the 1990s, it went through five technological generations. “Where do you go to get people who are used to that kind of change? The IT industry,” says Ms Sedel.

Everybody's favourite example of this migration of IT people to telecoms is Michael Capellas, formerly the boss of Compaq and number two at Hewlett-Packard, and now chief executive at WorldCom, the largest and most notorious of the bankrupt telecoms operators. Mr Capellas has renamed the company MCI and is trying to bring it out of bankruptcy this autumn, which is proving tricky. But if anyone can turn

WorldCom around, says Allan Tumolillo, an analyst at Probe Research, it is someone from the IT sector: “If they had pulled someone out of the telecoms industry, I would say they are going nowhere. But they brought in a guy from the computer industry.”

Computer firms, Mr Tumolillo observes, have an enormous stake in how telecoms networks are managed, because they are gambling that the future of computing lies in complex network-based technologies, such as web services (stitching together programs running on different computers across the internet) and utility computing (providing computing power on demand, like electricity or gas). “If the industry is stuck with slow-moving carriers, the computer guys suffer the most,” says Mr Tumolillo. He believes that Mr Capellas will attempt to position MCI as the most IT-savvy network operator. “They will say ‘this is the computer network of the future',” he says. With telecoms firms becoming more dependent on IT, and vice versa, the two industries are likely to become ever more closely intertwined.

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Who will buy my god box?

Oct 9th 2003
From The Economist print edition

Telecoms-equipment vendors have to take their business opportunities where they find them

“BOY, have things changed!” declares Niel Ransom, chief technology officer of Alcatel, a big telecoms-equipment vendor. In the good old days of the bubble, he explains, “I could talk to network operators about visions, sell them visions, they would invest in visions. But that's not today's market.” Visions are out, and the construction boom of the bubble years is just a fond memory. That does not mean spending has stopped, however. Mark Winther of IDC notes that capital expenditure by telecoms operators has plunged since the boom, but still adds up to a huge amount of money—around $160 billion this year. “Carriers are still spending,” he says, “but what they are spending on is changing. The big story is not just that capex is down, but that it's transforming.”

Operators are now concentrating their spending mainly on three areas: equipment to provide services, such as high-speed internet connections, that can provide new sources of revenue; ways of simplifying their tangled networks and reducing running costs; and software and other operating support systems that allow them to implement new services more quickly and efficiently. All three involve rearranging the plumbing around the edges of networks, not the large-scale construction in the core that accounted for so much investment during the boom.

As a result, equipment vendors who concentrated on optical switching gear, which is used in the core of telecoms networks, have been hit hardest by the bursting of the bubble. Few operators are building new fibre-optic networks, says Shin Umeda of Dell'Oro Group, a market-research firm. Some are adding to their networks here and there, he says, “but the expensive part of the business, fibre and optical transmission equipment, is in place, so they won't need to spend a lot more there.” Companies that make equipment for the edges of networks, on the other hand, have not been so badly affected. “The opportunity is at the edge,” says Mr Ransom.

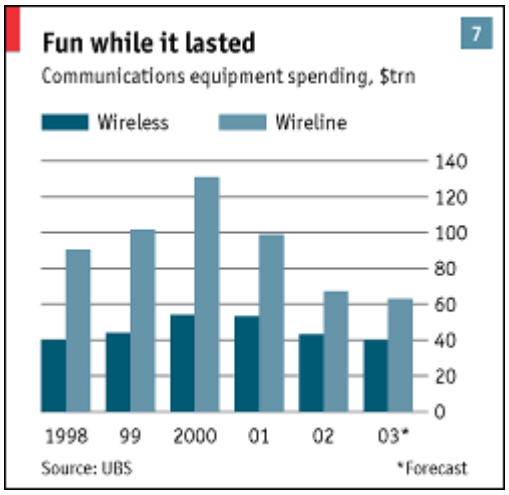
Some categories of network-edge equipment are growing very fast, says Tam Dell'Oro, the founder of Dell'Oro Group. She singles out digital-subscriber line (DSL) equipment, which is used to turn telephone wires into broadband internet pipes, and cable-modem equipment, which allows cable operators to provide broadband internet access over their networks alongside cable TV. Global sales of such equipment surged by 21% in the second quarter of this year, with the strongest growth in Europe, Asia and Latin America, where broadband is catching on fast as prices come down. The chief beneficiaries of this trend are firms such as Alcatel, Siemens, UTStarcom and Cisco.

Meanwhile, many operators are overhauling their networks to reduce running costs by combining traffic from multiple networks on a single backbone. Network operators have traditionally launched new services by building entire new networks, says Betsy Bernard, president of AT&T and head of its business-services arm. Each network has its own ordering and billing system, which results in duplication and inefficiency. “So during this lull in the action, we are retiring systems and integrating things,” she says. By the end of this year AT&T will have retired 190 systems, which should reduce running costs and allow the company to respond more quickly to customers. Many other carriers are doing the same. “Our network today is a kind of plate of spaghetti,” says BT's Mr Verwaayen. He pulls out a pen and starts scribbling network maps, explaining how BT is aiming for a new, simpler architecture that is more like lasagne. “I'm really thrilled about this,” he says.

The technology that BT, AT&T and many other operators are using to do away with network spaghetti is called multi-protocol label switching (MPLS). In essence, it allows multiple old-fashioned network services (such as voice, frame relay and ATM traffic) to be carried over a single modern network based on internet protocol (IP). MPLS has special traffic-management features giving priority to some forms of traffic over others, to ensure the smooth interleaving of different services. That makes it possible to “collapse” several networks on to a single network. Clever boxes around the edge of the network, known as “multi-service platforms” or “god boxes”, are used to translate traffic to and from various formats and protocols so that the transition is invisible to end-users. “Shunting complexity out to the edges will allow

us to simplify operations dramatically," says Hossein Eslambolchi, AT&T's chief technology officer.

The growth of interest in MPLS is good news for vendors such as Cisco, Juniper and Ciena. Mr Winther gives warning, however, that although the shift to MPLS looks increasingly certain, it will take many years. More significant for now is the network operators' growing expenditure on software, estimated at around $30 billion this year.



Software allows operators to offer new services based on their existing infrastructure (such as multimedia messaging or game downloads on mobile phones). Clever billing software can enable operators to introduce new tariffs or special offers. Customer-relationship management software can keep track of customers and target them with new products to stop them defecting. And self-service software can reduce costs by helping customers do things for themselves. For example, instead of setting up a DSL connection by sending an engineer to someone's house, the same job can now be done much more cheaply by putting the equipment in the post and using software to install it automatically. Network operators are also investing in websites to automate the configuration of new services (such as e-mail on mobile phones), provide technical support (to reduce the volume of calls to call-centres) and allow businesses to order and configure new network services.

Launching a new service, says Mr Winther, is increasingly a matter of gluing together existing systems using the appropriate software, rather than buying a dedicated box from an equipment vendor. This growth in the importance of software favours vendors in the computer industry, such as IBM, Hewlett-Packard, Sun and Oracle, rather than telecoms-equipment vendors. "I'm sceptical that traditional equipment vendors, who make network elements and hardware, are going to be able to invest enough resources to create a credible proposition in service creation and delivery," he says.

Vendors are responding to these shifts in a number of ways. Many are carefully picking the markets in which they wish to remain. "Two or three years ago, everyone wanted to do everything for all customers," says Cisco's Mr Volpi. "Now the competition is much more segmented and the degree of overlap is lower." Cisco, for example, has backed out of the long-haul optical market and formed an alliance with another vendor, Lucent, in mobile-phone wireless infrastructure. Lucent has formed another alliance with Juniper, distributing that company's MPLS equipment rather than developing its own.

We'll do anything for you

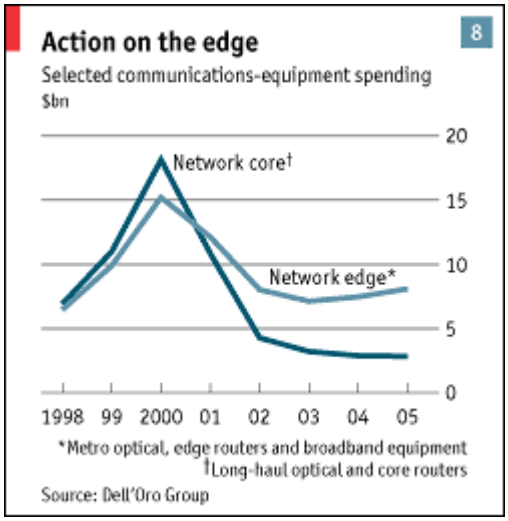
Another defensive move by equipment makers has been to move into the already crowded services market. Previously, says Mr Winther, vendors would ship a large amount of equipment to a network operator, who would arrange for it to be unpacked and installed by employees of a systems integrator. Now equipment makers such as Alcatel offer to install and manage new equipment, including that supplied by other vendors. "Carriers have no sacred cows and will outsource anything," says Mr Winther.

A good example, says Alcatel's Mr Ransom, is Telecom New Zealand, which has just outsourced the management of its next-generation fixed-line network to Alcatel, and the construction and management of a new mobile-phone network to Lucent. "We are starting to see that worldwide," he says. "Oil companies buying network equipment are saying we want to search for oil and run pipelines, not run a network." Mr Winther cautions, however, that outsourcing always looks more attractive when companies are striving to cut costs in an economic downturn. When things improve, he says, vendors may find that their services businesses will suffer.

By then, however, equipment makers hope that business will have picked up in other areas that look gloomy at the moment. Once the teething problems have been sorted out and mobile data services have gathered steam, for example, demand for 3G base-

stations should start growing. For now, though, mobile operators are delaying investment in 3G and trying to squeeze as much revenue as possible out of their 2G and 2.5G networks.

Another potentially promising area is “fibre to the premises”, which involves running fibre all the way into homes, offices and schools to provide far higher access speeds than are possible with today's DSL and cable-modem technologies. Such deployments are already under way in Japan and South Korea, and a consortium of incumbent operators has announced plans to deploy the technology in America. If it happens, this would mean spending tens of billions of dollars over the next 10-15 years. But given the current climate, vendors are not getting excited just yet. “The thought is that once there's enough bandwidth to the user, the core will start to fill up and will come alive again,” says Mr Ransom. “But not today.”



For the time being, equipment makers must concentrate on the few hotspots of activity within the industry. And however much things improve, says Mr Winther, capital spending will never return to the levels seen during the boom. Operators' capital expenditure as a percentage of their revenues will stay in the low teens, he predicts, far short of the 30-50% of the boom years. For equipment makers, the party is well and truly over.

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Untangling the local loop

Oct 9th 2003
From The Economist print edition

Current telecoms regulation has its flaws, but the alternatives are probably worse

WHO would want to be a telecoms regulator and sit in judgment over squabbling, litigious operators? In most countries, the incumbent is required to make bits of its network available to competing operators, in particular the “local loops”—the wires that run from telephone exchanges into homes and offices. The incumbent must, in effect, give its rivals a hand as they try to steal its business. Not surprisingly, most incumbents find procedural, legal and technical reasons for being slow about it. Their rivals, in turn, want regulators to intervene on their behalf to hurry things up. Regulators must therefore strike a balance and resign themselves to unpopularity. Only when everyone is complaining equally loudly can they be sure that the system is fair.

How best to promote competition over the local loop is by far the most controversial topic in telecoms regulation. Ideally, competitors would put an end to the incumbents' local-loop monopoly by building their own networks. But building a competing network with the same reach is hugely expensive and time-consuming. Cable networks generally provide coverage only in some areas, and mobile-phone networks cannot yet offer broadband internet access. So, over the past few years, most of the developed world has been asking incumbents to share their networks with rivals—technically known as “local loop unbundling” (LLU). This means treating the incumbents as a special case and regulating them in an “asymmetric” way, at least until competing networks have been constructed. By allowing competitors to lease or resell lines, regulators have been able to foster competition in both telephony and broadband access.

But there are a number of objections to the unbundling approach. The first is that although it may promote competition, it inhibits investments that competitors might otherwise have made. Unbundling thus boosts competition in the short term, but makes it less likely that a competing infrastructure will be built. “In correcting the evils of the past it preserves them, and extends them into the future,” says Adam Thierer of the Cato Institute, who once supported unbundling, but now fiercely opposes it. “Sharing is not competing—it is a means to an end until you have full-blown competition,” he says.

Second, forcing incumbents to share their networks with rivals may deter them from investing in new equipment too. Certainly the practice appears to have slowed down the introduction of broadband in some countries. Another objection to unbundling is that it requires close and continuing regulatory oversight to ensure that the incumbents play fair, set reasonable wholesale prices and act quickly when problems arise. Although it is often described as deregulation, unbundling actually means more regulation. It also leads to legal challenges as incumbents try to slow down the unbundling process. Disagreements over America's unbundling regime, known as UNE-P, have twice gone all the way to the Supreme Court, and incumbents in other countries have also gone to court to oppose unbundling

regulations.

Unbundle this

So what are the alternatives? Given the Cato Institute's enthusiasm for deregulation, it comes as no surprise that Mr Thierer would like to see America's unbundling regime scrapped altogether. He proposes dismantling it in 2006, ten years after it was introduced by the Telecommunications Act of 1996. The main benefit, he says, is that it would end the current regulatory uncertainty.

However, this piece of deregulation would, in effect, create deregulated local monopolies, observes Jim Cicconi, AT&T's general counsel. AT&T is a long-distance operator that leases local lines from the incumbent Baby Bells, and competes with them in offering local telephony services in several states. “Once market forces are able to take root, and competition is able to emerge, you can deregulate,” he says. “But what happens when you deregulate incumbent monopolies? Do you magically get competition?” Admittedly many people can use mobile phones, and can get broadband access, and possibly telephony too, from a cable company. But some subscribers would be stuck with the incumbent network operator.

At the other end of the regulatory spectrum is an alternative to unbundling that involves much more, rather than less, intervention: so-called “structural separation”. Because each incumbent owns its network, goes the argument, it will always have an advantage over its rivals. The only real answer is to hive off the incumbent's network. The incumbent would be separated into two parts, often referred to as LoopCo (which would own the local-loop network) and NetCo (the rest of the company). LoopCo would make lines available to all comers, just as incumbents are required to do now. NetCo would have to lease lines like any other operator.

But there are some big problems with this approach, too. In particular, who owns LoopCo? Nationalising it would be unthinkable in most countries. But if LoopCo were a private company, then one monopoly would simply have been replaced with another, notes Henry Elkington of Boston Consulting Group. It would therefore need to be closely regulated. At the same time, regulators would have to ensure that LoopCo did not give preferential treatment to NetCo, or indeed to any other operator. Given all these complications, there is little chance that any government would be prepared to do something so drastic and potentially messy.

Best not to fix it

In the end, there is a lot to be said for doing as little as possible. “With everybody still nursing a hangover, messing things around in a radical way is not what's required,” says Mr Elkington. Rather than scrapping existing rules altogether, regulators are making gradual changes in carefully targeted areas. America's telecoms regulator, the Federal Communications Commission, has recently completed a review of its rules, and has decided to leave things much as they were—despite furious lobbying from the Bells, which plan to appeal. But there was one particularly noteworthy ruling: if the Bells proceed with their joint plan to build a new fibre-optic local loop, they will not have to share it with competitors. In short, the unbundling rules apply to old networks, but not necessarily to new ones. This should encourage investment in the long term.

Europe has also updated its regulations recently, but in a way that makes little visible difference, at least in the short term, says David Cleevely of Analysys, a telecoms consultancy. The new rules have yet to come into force in all EU member states, but they attempt to do away with telecoms-specific legislation, and instead apply a more general antitrust approach. The telecoms business is divided into specific markets, such as fixed-line voice, mobile and broadband, and any company that appears to be exploiting significant market power in any market can have various remedies imposed upon it. The new rules should give Europe's telecoms regulators more flexibility.

Still, the pace of technological change makes it unlikely that telecoms will ever be able to shake off industry-specific regulation and become a “normal” industry. According to Mr Cleevely, regulators will, if anything, need even greater technical expertise in future.

The American railway industry of the 19th century provides an informative comparison. Steven Usselman, a historian at the Georgia Institute of Technology and the author of a book on railway

regulation, notes that railways were heavily regulated until an alternative means of transport—interstate highways—became available. Until then, railways had to ensure open access to their infrastructure, just as incumbent telecoms operators do today. But even now, says Mr Odlyzko of the University of Minnesota, railways have not been completely deregulated. Incumbent telecoms operators may find themselves in the same position. For even when competing telecoms infrastructure of some kind or another has at last been built, in some parts of the world former incumbents may still provide the only means of network access, so the need for at least some regulation will remain.

So what kind of technology will eventually topple the incumbents' local-loop monopoly? Different technologies are likely to be used in different places, and cable and fibre-to-the-premises will both play a role. But the single most important technology will probably be wireless. Once this technology is capable of transmitting data at broadband speeds, wireless will also be the quickest way to blanket neighbourhoods, cities and countries with broadband access. The mania for Wi-Fi, which provides internet access within a short distance of a base-station, offers a glimpse of this future. But it will be new wide-area wireless-broadband technologies, rather than Wi-Fi, that will form the basis of the new wireless local loops.

As this survey has argued, the three trends currently driving the telecoms industry are wireless, broadband, and the convergence of voice and data, telecoms and information technology. With luck, technological progress and regulatory vigilance, these three trends between them will overthrow the local-loop monopolies some time during the next ten years.

Internet technology rules OK

Already fixed-line voice-based networks are being eclipsed by a multitude of packet-based data networks on which voice is just another kind of data. This is a remarkable victory for internet technology. Eventually, all of those packets of data will be carried using internet protocol (IP), which continues to reach into every corner of telecoms, pushing aside rival technologies wherever it goes. “IP will eat everything in the next decade,” says AT&T's Mr Eslambolchi.

So there was a kernel of truth in the internet-inspired mania after all. At the heart of the telecoms industry, internet technology continues to sweep all before it, even though large numbers of firms have gone bust and markets have collapsed. This internet-powered future, when it fully arrives, will have proved much harder to reach and taken much longer than the telecoms cheerleaders of the 1990s forecast. But that is the nature of revolutions: they are rarely as quick or as clean as the revolutionaries expect.

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Oct 9th 2003
From The Economist print edition

The author wishes to express his gratitude to everyone who helped with the compilation of this survey, all of whom are quoted in the text. Special thanks go to Andrew Odlyzko of the University of Minnesota and Henry Elkington of Boston Consulting Group.

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Oct 9th 2003
From The Economist print edition

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Home improvements in China

Doing up the Middle Kingdom

Oct 9th 2003 | SHANGHAI AND SHENZHEN
From The Economist print edition

Imagine China

A boom in private housing is fuelling a new market for home decoration and could change the way the Chinese shop

GAUDY paper lions dance between shopping trolleys. The store is full bright lights, banners and orange-clad helpers beaming at the throng of eager shoppers. In one corner, children hammer together pieces of wood, while in another rapt adults are watching a product demonstration. Everywhere, customers are pulling items off shelves to touch and even smell them. But this is no toyshop at Christmas. It is the recent opening of B&Q's newest store in Shenzhen. “Home improvement” has arrived in China—and with it, a potential shopping revolution.

As with so many opportunities in the world's most populous country, the market promises to be huge. B&Q, part of Britain's Kingfisher retailing group, estimates that one-tenth of China's 400m households have “western” levels of disposable income, with $1,000 or more a year to spend on home improvements. That number is increasing rapidly. Government deregulation (Chinese used to rent accommodation from their work units) is boosting home ownership by 30% a year. Along with home ownership comes an interest in decor. China's home-improvement market, estimated to be worth almost 200 billion yuan ($24 billion) two years ago, has since grown much bigger. “Chinese people have the money, intention and desire to improve their homes,” says David Wei, head of B&Q China.

In readiness, foreign chains are trying to move quickly ahead of new rules that will allow them to open shops anywhere in China from December 2004. B&Q is already China's biggest chain by sales. Its foreign rivals include Sweden's IKEA and Germany's Obi. America's giant Home Depot, which already has links to Homeway, a Chinese chain, may enter in its own right. China's domestic retailers, including Homemart (the second biggest), No 9 and Orient Homes, are expanding. B&Q plans to open 12 new stores a year. It has doubled sales each year since it opened its first store in China in 1999, and will have 15 stores in seven cities by the end of the year, including its largest-ever store, which opens in Beijing in October. Steve Gilman, head of B&Q International, wants to have 75 stores in 30 Chinese cities by the end of 2008. If everything goes to plan, analysts think that by 2010, China could contribute £3 billion ($5 billion) of sales and £185m of operating profit, one tenth of Kingfisher's present operating profit.

Trust me

But that would require big changes in how retailing works in China. The key advantage foreign chains

currently have is trust. Chinese shoppers are used to being sold shoddy goods backed by dodgy guarantees. Their defence is to negotiate fiercely and examine goods carefully. Wandering around B&Q's Shenzhen store, 34-year-old Yuan Ye is reassured by the fact that it is foreign. “I can trust international retailers,” she says. Signs around the shop promise “no fakes” and money-back guarantees. In China, B&Q even takes customers to workshops to reassure them about quality.

Ms Yuan also likes the idea of one-stop-shopping. In China, retailing is over-specialised. Along Hong Kong's home-improvement alley, Lockhart Road, one store sells door handles, another paint and yet another paintbrushes. On the mainland, new homes are often concrete shells, with no plumbing or even dividing walls. Decorating takes enormous energy, requiring trips to scores of stores, and a hunt for a reliable contractor. B&Q is profiting from this. Its “home solutions” service will fit out an entire house, including furniture, and guarantee all the work. It is proving to be very popular, boosting B&Q's same-store sales in China by 19% this year and prompting it to experiment with the same service back in Britain, where the home-improvements business is more popularly known as do-it-yourself (DIY).

The big challenge facing B&Q, and its rivals in China, is that most customers are not doing it themselves. “Chinese DIY is still really BIY—buy it yourself,” admits Mr Wei. Government policy is to build homes that are more finished, so B&Q needs to turn DIY into more of a hobby and the Chinese into a nation of home improvers, like the Americans and British. Yet middle-class Chinese feel it is beneath them to build a cabinet or fit a shelf and, thanks to the abundance of cheap labour, have never had to. Many Chinese don't know how to wire a plug or rise to the challenge of scumble painting. So the company is giving its customers lessons, showing them how to use a drill, for instance, and even teaching children the mysteries of self-assembly furniture.

Even if B&Q succeeds in changing how people shop, it must also change its supply chain. In a low-margin industry like retailing, efficient suppliers are the key to success. However in China, getting goods into stores is expensive and costly, says David Inglis, head of operations for B&Q China. The company's gross margins in China are half of those of its international division, and the group will not break even (excluding pre-opening costs) until 2005 on an investment of $120m and rising. China's huge size and enormous regional variations mean retailers struggle to establish a national infrastructure, let alone a national brand. Laminated wood, for example, cannot survive Shenzhen's humid summers while the aquariums popular in the southern city freeze over during a Beijing winter. “It's like operating in different countries,” adds Mr Inglis.

As a result, even the biggest retailers remain in thrall to regional manufacturers—and their middlemen—which raises costs. B&Q has 600 vendors supplying its 350 British stores but 1,800 for 15 Chinese ones. Even worse, these middlemen cut deals behind retailers' backs. Even on the shop floor, vendor representatives routinely offer customers “special” prices. Mr Gilman is concerned: “This is a state-controlled economy. Price fixing is endemic. Retailers are at the bottom of the food chain in China. They have far less power than manufacturers. It is the opposite of the rest of the world.”

B&Q is heroically trying to change how its suppliers operate. From next year it plans to open regional warehouses and to buy directly from manufacturers. It also wants to turn suppliers into partners. Nippon Paint makes B&Q own-label paint, which earns a margin of over 20% for the retailer, compared with 6% for an independent brand. But even as market leader, B&Q is still not yet big enough to matter in such a vast market. Even if it were, foreign retailers are treated inequitably. They pay sales tax which tiny stores have the *GUANXI* (connections) to avoid. They are frequently offered only the poorest sites—B&Q had to build its new Shenzhen store under a residential tower block, for example. Nor does cheap labour compensate. While staff costs in China are a third of those in Britain, B&Q needs twice as many people per store to meet the greater service levels expected.

Even if foreign retailers can make China's retail industry efficient, shoppers will not readily trust their promises. In Shenzhen and Shanghai, China's most western cities, customers in B&Q still try to haggle over price. And even Ms Yuan, the customer in the new Shenzhen store, walked out empty handed. “I need to check the prices of the local specialists down the road,” she explained.

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About sponsorship

Asia's consumers

A billion boomers

Oct 9th 2003 | JAKARTA AND KUALA LUMPUR
From The Economist print edition

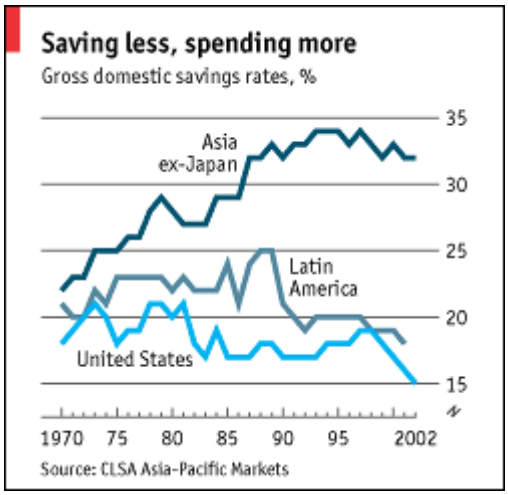
Spending like never before

TESTAMENT to Malaysia's economic prowess, the 88-storey Petronas Twin Towers in Kuala Lumpur are gleaming and marbled, but the office space in one of them is half empty. The real economic story is unfolding at the foot of the building, on the six floors of the luxurious Suria shopping centre, which is heaving with smartly-dressed people buying Bulgari watches, Nokia phones and Clarins beauty treatments.

All across Asia, consumers are waking up and finding their voices, or at least their wallets. They are younger than their counterparts in the West. They are also growing richer and are less frugal than their high-saving parents. Above all, there are lots of them.

Christopher Wood, emerging-markets strategist at CLSA, a Hong Kong broker, talks of "Asia's billion boomers": in 2000 there were 1.2 billion Asians aged between 30 and 59. That will rise to 1.7 billion by 2020. Over the same period, the same age group in western Europe, and even in America, will shrink.

Asia's boomers are blessed with increasing spending power. Some 1.4 billion may, by 2020, earn at least $5,000 in today's money—the point at which discretionary spending takes off—compared with 306m now. And Asians are moderating their traditionally high savings rates (see chart). Above all, Asia's growing number of well-educated, sophisticated singles and couples enjoy a sense of confidence in their own rising living standards that mirrors that of the Eisenhower generation in 1950s America.



They are spending their money on their homes, consumer durables, luxury goods, tourism and even financial products. In China, car sales have risen by 82% in the first half of 2003. In Hong Kong, rich mainlanders are snapping up luxury flats. Gucci and LVMH are opening new stores in deflationary Japan. Meanwhile, Stewart Hall, chief executive of Standard Chartered's bank in Indonesia, reports a boom in mortgages, credit cards and personal loans: "The engine of growth is the consumer market," he says.

These spending patterns are transforming Asia's hitherto export-led economies. Exports and corporate investment still comprise 38% of GDP on average, according to CLSA, but governments from Malaysia to Thailand are openly encouraging consumer demand to foster domestic growth—often, pointedly, as a counter to foreign direct investment. That can be taken too far: South Korea encouraged a credit-card boom that quickly turned into a bust and plunged the region's third-largest economy into its first recession since the Asian financial crisis in the late 1990s. Despite such occasional bumps along the way, however, Asia's consumers may soon replace America's as the drivers of global growth.

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Business and AIDS in Africa

Follow my lead

Oct 9th 2003 | JOHANNESBURG
From The Economist print edition

Companies take practical steps to help Africa's AIDS tragedy

WHY are companies in Africa becoming involved in public health? This week Anglo American, a global mining giant, said it will help pay for the rehabilitation of 900 South African public clinics where HIV testing and treatments for AIDS and tuberculosis are carried out. The mining firm is hardly breaking the bank by spending 30m rand ($4.5m) in the next three years. But it is setting a potentially important precedent by paying for the treatment of not just its own workforce, but for others as well.

Now helping the family

The company's announcement is also a step on from August last year, when it said that it would give anti-retroviral drugs to HIV-infected employees. In part that was a political gesture: when firms began to give out useful drugs to workers, the government came under more pressure to follow suit for the 5m HIV-infected South Africans. But ministers are still deciding just how and when to do this; other African rulers are rolling out programmes, though far too slowly.

Brian Brink, Anglo American's vice-president of health, argues that treating infected workers does indeed serve the bottom line. The company says gains to staff morale and productivity will outweigh drug and other health costs. Most big miners in Africa, such as Debswana, a diamond digger in Botswana, and firms in other businesses, such as Coca-Cola and Vodacom, a South African mobile-phone company, do the same. Diageo, a drinks maker, said last month that its HIV-positive African workers would all get the drugs they need.

This probably does make business sense, as well as being a good thing to do. Drug regimens are getting cheaper each year, and they keep workers on the job. Though it now costs Anglo American $4,000 annually to treat a worker—more than many are paid—that should drop to $1,400 as more are treated. Just 750 of the firm's 30,000 infected South African employees now get treatment, but 97% of them are back in full-time work, including heavy-duty physical labour. Sanlam, a life assurer, suggests that firms with comprehensive health policies may also avoid sharp rises in life, disability and medical insurance premiums.

In contrast, HIV-infected workers who get no treatment typically take 55 days of sick leave in their final two years at work, says Sanlam in a newly finished survey of South African firms. That is a big loss where skilled labour is scarce. In South Africa, at least one-seventh of the formal workforce is infected. Elsewhere in southern Africa, the rate is higher. Even for unskilled jobs, the costs of high turnover may be greater than the cost of treatment.

No surprise, then, that South African firms are choosing to care for their workers. The Sanlam survey suggests roughly half have an official AIDS policy and nearly a third offer workers counselling and HIV testing. Over a quarter actually implement some form of health-care programme. The trend will continue: South African students of business administration are now told to review company AIDS policies and design better ones. The Johannesburg stock exchange is still considering whether to force listed firms to publish health strategies, but many firms expect it to do so in the next couple of years.

But why move on from caring for your workers to helping fund public health? David Harrison, of loveLife, an AIDS activist group which will use Anglo American's donation (and funds from other foundations, the United Nations and the South African government) to rehabilitate the public clinics, says many other firms are keen to follow suit. Anglo American's Mr Brink calls the expansion a “logical extension of everything we have been doing in the workplace.”

Logical? Yes. Firms find it difficult to give tests, counselling and drugs to an employee, while doing nothing for his sick wife or their ailing children. Workers also fear that losing a job means a death sentence, as treatment would stop. By funding clinics, especially in rural communities where the company is the main employer, such problems can be eased.

Firms may also be associated with success. The clinics are designed to attract, test and treat young teenagers, the only age-group in South Africa that has shown, for three years running, a sharp decline in HIV infection rates. This is also the pool from which firms will have to replenish their workforces. It is time that governments, too, began to show such foresight.

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Mexican soft drinks

Cola down Mexico way

Oct 9th 2003 | PUEBLA
From The Economist print edition

A new bottle on the block in the world's second-largest soft-drinks market

Get article background

THE unprepossessing plant of Kola Real is easy to miss, hidden away in an anonymous industrial park on the outskirts of Puebla, just to the east of Mexico City. In terms of manufacturing, Puebla usually does things on the grand scale: a huge Volkswagen plant dominates the city's economy. Kola Real might be tiny by comparison, but the challenge ahead of it is as big as anything the giant car manufacturer has ever contemplated. Kola Real intends to break into the most lucrative and toughest soft-drinks market in the world. It has even tasted early success. But can the young upstart really take on the combined might of Coca-Cola and Pepsi?

A Peruvian company, Kola Real was founded only 15 years ago. After considerable success at home, and expansion into Venezuela and Ecuador, the company decided to target Mexico. It is easy to see why. According to Canadean, a beverages research company, Mexicans consume, per head of population, 101 litres of cola a year, which is only slightly less than the Americans at 113 litres. By comparison, further south the Brazilians consume a paltry 32 litres a year.

Not surprisingly, Coca-Cola and Pepsi have had the Mexican market just about sewn up. Coca-Cola has 70% of the Mexican carbonated soft-drinks market, and the country represents about 11% of its worldwide sales. Even the Mexican president himself, Vicente Fox, is a former Coca-Cola executive. Pepsi has about 15%, but is even stronger in the north of the country. Other companies make up another 11%.

So the entry into the market last year of Kola Real with its product, Big Cola, really did represent a battle of David-and-Goliath proportions. The little upstart believes that it has a winning strategy. Carlos Ananos Jeri, the head of the firm's Mexican operation and one of the brothers that runs the family-controlled business, says that before his firm entered the market, the equivalent bottle of cola cost $1 in the United States but $1.40 in Mexico, a much poorer country. “This looked like a big opportunity” to launch a similar product at a cheaper price, he says.

Big Cola began with just one family-sized 2.6-litre bottle. The suggested price is 10 pesos (90 cents), but it can sell in the shops for 9 pesos. This is a marketing formula that has worked well in Peru, where Kola Real has a 17% market share. The strategy also seems to be working in Mexico. Since the Puebla plant opened in March 2002, the company has grabbed a 3.5% market share.

To turn a profit, Kola Real runs a truly no-frills operation; its Puebla offices are as austere as corporate headquarters come. There is a tiny administrative back-up team, and very little advertising. The company relies on taste and word of mouth to promote its product. Part of the reason that costs are kept so low is that the company has had to set up its own distribution network rather than rely on and pay others to do the job. A fleet of 600 leased lorries takes the bottles from Puebla to 24 distribution centres, where 800 salespeople try to get Big Cola into supermarkets and, more importantly, into the corner shops that dominate the rural retail trade.

At present, Kola Real has 100,000 points of sale, but the plan is to expand that to 900,000. Getting its product to so many shops will be the hardest part. Nor will Coca-Cola and Pepsi sit idly by. The two companies have recently embarked on aggressive marketing campaigns, particularly targeting the vital teenage market. There have been complaints that Coca-Cola has been abusing its dominant market position by paying retailers to stock its products exclusively. Mexico's Federal Competition Commission ruled against the company in this matter last year.

Perhaps more menacingly, the big two have now started attacking Big Cola's main selling points: volume and price. Joseph Borman, Latin American beverages analyst at Fitch Ratings, argues that both Coca-Cola and Pepsi have unusually lean operations in Mexico, and have been “more nimble than in other markets” at responding to competitors. Both companies now have 2.5 litre bottles in the shops, with Pepsi's offering selling for 12 pesos—only slightly more than Big Cola. Despite this riposte from his big rivals, Mr Ananos hopes to lift Kola Real's share of the Mexican market to 10% in five years. That may be optimistic. But at least the sweet-toothed Mexicans should get cheaper drinks as the cola war rages.

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Biotechnology

Carbon copy

Oct 9th 2003
From The Economist print edition

Making generic biotech drugs will be a tough business

FEW companies see imitation as flattery, particularly big drug firms fighting to maintain their patents on blockbuster drugs and to stop makers of generic drugs from churning out copies once those patents expire. But the biotechnology business has been largely immune to such competition, because most firms are still struggling to turn their ideas into products.

Now the patents for some of the early biotech drugs are beginning to expire. By 2006, 11 biotech drugs, worth more than $13 billion in annual sales, could face generic competition in America, according to Datamonitor, a research consultancy. But as tempting as this market may seem, getting into the business of making bio-similar drugs, as such generics are called, will not be easy.

To begin with, there are technical hurdles. Making a copy of a conventional drug, such as Viagra, is largely a matter of reverse-engineering. Bio-similar drugs, however, are much fiddlier. Many are complex proteins that can be synthesised only by using living cells. The process is prone to contamination and is highly variable, making the task complex and costly.

Getting bio-similar drugs to the patient is also tricky. Most generic companies sell to pharmacists, who in many countries are allowed to dispense them as substitutes for expensive branded drugs. Biotech drugs, however, are mainly administered by doctors. This means that the marketing of generic versions will have to be redirected to physicians. But generic-drug makers lack the cosy relationships that many patent holders have with doctors. It could cost up to $25m to bring a bio-similar to market, ten times more than a conventional generic, according to Lehman Brothers, an investment bank.

This means that competition in bio-similars is likely to be limited—and hence prices of the drugs will stay relatively high. Steve Usdin, who writes for *BioCentury*, a trade publication, reckons that generic biotech products will sell for roughly 60-80% of the price of the patented original. For conventional drugs, generics can easily sell for as little as 20% of the branded price in the first year.

Such savings would still be worth having, given the high price of biotech drugs. But the regulatory barriers are formidable. Unlike the costly and time-consuming clinical trials that big drug firms have to undertake with new drugs to win the approval of regulators in America and Europe, generic firms have only to show that their copycat versions are chemically identical and behave in the body in the same way. Regulators are wary of allowing the same approval process to apply to biological generics, where even the slightest difference in production can lead to subtle changes in a protein. This, in turn, can make it behave quite differently in the body. The substantial cost of clinical trials, and the close monitoring of products in the market, could greatly lower the profits in bio-similars, according to Richard Kingham, a regulatory expert with Covington & Burling, an American law firm.

The European Commission is currently working on rules to help drugmakers bring bio-similars to market, which may include abbreviated application processes. America's efforts to follow the Europeans with similar initiatives, however, are hampered by various legal difficulties which may require new legislation. In the meantime, BIO, the American biotech trade body, is lobbying the federal Food and Drug Administration not to allow generics makers to get away with anything less than full applications.

Given these hurdles, only a few generics makers are likely to take the plunge. For example, Sandoz, based in Vienna, hopes to be first on to the European market next year with its generic version of human growth hormone. But Sandoz is unusual in that it is part of Novartis, a leading pharmaceutical firm, and so can draw on its parent's expertise and deeper pockets for help.

Alternatively, as Viren Mehta, a pharmaceuticals analyst at Mehta Partners in New York, points out, firms better-placed to introduce bio-similars into Europe and America are those already working outside these key markets, in India and China for example, with years of experience manufacturing, testing and selling generic products in places where patents have not been strictly enforced. This includes firms such as Dr Reddy's and Wockhardt, two Indian drug firms, and Pliva, a Croatian generics-maker. If such companies can overcome all the difficulties, bio-similars could provide them with a lucrative route into western markets.

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East European steel

Mittal's mettle

Oct 9th 2003 | WARSAW
From The Economist print edition

Another big and rusty challenge

OUTMODED, debt-laden and overmanned, Huta Katowice is the largest in a clutch of Polish steel mills being privatised as part of Polskie Huty Stali (PHS)—an unlikely prize for a foreign investor. Yet LNM, the world's second-largest steelmaker, whose initials are those of its founder and boss, Lakshmi Mittal, a London-based Indian billionaire, has a penchant for distressed post-communist steelworks. If it finalises a recent deal to buy the concern, LNM would mark the firm's fourth East European acquisition since rescuing Kazakhstan's Karmet plant in 1995.

Along with US Steel, the other shortlisted bidder, LNM has become a white knight of the region's sickly steel industry. But it has not been smooth sailing. The firm's acquisition in 2001 of Romania's loss-making Sidex mill was tarnished by allegations that a large donation was made to Tony Blair's Labour Party to get the British government to lobby the Romanian one on its behalf. Although Mr Mittal denied that there was any connection between the donation and the Sidex bid, the affair still dogs him.

His chumminess with Kazakhstan's authoritarian president, Nursultan Nazarbayev, has raised eyebrows too. Yet he wins plaudits for turning around the once-decrepit Karmet. “The man is a national hero in Kazakhstan,” says Philip Tomlinson of the CRU Group, a steel consultancy.

The Romanian Sidex plant, which was deep in debt when LNM took it over, has also been swiftly revived, and the Czech Republic's Nova Hut, acquired by LNM last year, is getting back on its feet. Sorting out the Polish steel sector would be a bigger feat. The government only recently heeded a decade of advice to consolidate its big mills. If LNM does acquire PHS—it is currently negotiating a “social package” with combative trade unions as part of a deal that would involve a complex debt-for-equity swap—it will venture into Poland's depressed Silesia area, already hard hit by coal mine closures.

Mr Mittal believes eastern Europe presents huge opportunities for steelmakers. As post-communist economies grow, so will the demand for quality steel, particularly from the large automotive and white-goods manufacturers. His next quarry may be Dunaferr, a troubled Hungarian mill that is about to be sold. But the PHS bid could dampen his appetite. Poland's nationalist parliamentarians want it to remain in state hands and have been busy grilling the treasury ministry about Mr Mittal's controversial past.

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In-flight e-mail

Goodbye peace

Oct 9th 2003
From The Economist print edition

Now there is no escape from the office: broadband at 35,000 feet is coming

YOU might be reading this on a flight, say from Europe or America, to your factory in Guangzhou. Perhaps you are sipping a drink and enjoying being away from the office hurly-burly. You may even be looking forward to a movie. But all that is going to change: the internet for airline passengers is coming.

Air-travel interludes have always carried a hidden price. If you do a long-haul trip like this every other week, you are out of touch with your company for some 30 hours—the equivalent of three working days. As Scott Carson, head of Connexion by Boeing (CBB), an aviation-internet firm, points out, this means you probably pay for the enforced leisure of the flight by spending the following weekend catching up with e-mails.

CBB's all-singing, all-dancing satellite broadband service is supposed to change this. It will be launched in a partnership with Lufthansa from March next year. The German airline will put the service on its 80 long-haul aircraft. But there is another contender: a small start-up known as Tenzing from Seattle, Boeing's backyard. Its biggest shareholder is, of all people, Boeing's archrival, Airbus. Tenzing's service is shaping up as the equivalent of a low-cost airline, offering barely more than e-mail for a few dollars. CBB, by comparison, will be like a business-class seat on a big carrier, costing a lot more but with added features.

Both companies have struggled to get beleaguered airlines to sign up. But each is now making progress. Tenzing has given up trying to run the whole service itself and opted for partnerships through which it adds its clever technology to the airborne phone service offered by companies like Verizon, the world's biggest telecoms firm. For another $10 on top of Verizon's $5.99 JetConnect phone service, a passenger can get e-mail. “Our name appears nowhere now,” says Alan McGinnis, Tenzing's boss. Six airlines (United, Continental, Northwest, Virgin, Iberia and Cathay Pacific) have signed up with Tenzing. Three more could soon. After Boeing's successful trials with Lufthansa and British Airways (BA) earlier this year, Japan Airlines, All Nippon Airways and SAS are also joining its service. BA remains to be convinced.

CBB is likely to cost $30 per flight—and cost an airline up to $700,000 to fit each aircraft with the necessary equipment. Neither Boeing nor Lufthansa is keen to talk about any details. CBB may be more expensive, but it does offer other benefits with high-speed broadband—including connecting the aircraft itself to a carrier's operations centre.

One outcome could be that the Boeing system takes the lead on long-haul flights, while Tenzing corners the short-haul market. Tenzing says it will upgrade the speed and scope of its service, once technology lowers the price. Whatever happens, those long, lazy hours of a business-class flight are soon to become a distant memory.

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Face value

Click and fly

Oct 9th 2003
From The Economist print edition

Cubitt Consulting

Dinesh Dhamija's online travel agency prepares for a fight

LIKE many people in the travel business, Dinesh Dhamija thought he might go bust after the September 11th attacks on America. Earlier this year, prospects again looked bleak with terrorist threats, the Iraq war and SARS. And an unusually hot summer persuaded many northern Europeans to holiday at home. But the desire to travel remains powerful. Once again, people have begun to shrug off their concerns and pack their bags. Travel bookings this autumn are strong. And that comes as a blessed relief to the London-based company that Mr Dhamija founded, ebookers. His firm now looks set to become one of the first big online travel agencies to start making an annual profit.

Mr Dhamija does not consider himself an internet pioneer, but rather a veteran of the travel business who quickly grasped the potential of going online. In an industry notorious for booms and busts, searching out razor-thin profit margins has long been crucial. So too has been persuading airlines to give you their best deals in the form of so-called “merchant fares”, a process of relationship building that can take years to reach fruition.

Mr Dhamija, the son of an Indian diplomat, got into the business in 1980 when he set up a travel agency with his wife at Earl's Court, one of London's busiest Underground stations. These were the days of “bucket shops”. With the connivance of some airlines desperate to fill unsold seats, travel agents would skirt the rules of the European airline cartel to sell discounted tickets. That changed with the spread of American-style airline deregulation, which eventually took the discounting business online.

Been there, clicked on that

The need to drive down costs remains as strong as ever. To survive the 2001 downturn, ebookers took a brave decision for a relatively small company and transferred most of its back office to Delhi. “It was the sort of thing people would expect *Fortune*-500 companies to do, but it helped save us,” says Mr Dhamija. He also hopes it has put the business on a good footing to face the next phase he expects in the development of online travel: a brutal shakeout among the many hundreds of competing firms.

Selling flights online has come a long way since Alaska Airlines sold the first ticket on the internet in 1995. Since then, sales have soared and today travel has become the biggest e-business in the world. Forrester, a research company, reckons Americans alone will spend more than $27 billion on online travel bookings this year. Some of the biggest online agents are American, including Expedia, Orbitz and Travelocity, which is owned by Sabre, a giant airline computer-reservation firm.

The Americans are keen to expand into Europe, where online booking is thought to be barely 5% of the market, compared with some 15% in America. Many analysts expect online bookings will comprise 30% of all bookings in America by 2005. European firms are also expanding fast, often through acquisitions. Ebookers and its chief rival, lastminute.com—also based in London and, say analysts, also heading for annual profitability—are among Europe's biggest operators.

The growth of online booking has not only been at the expense of bricks-and-mortar travel agents, but also of Europe's big package-holiday industry, which traditionally kept prices low by using charter airlines. Nowadays people can go online and put together their own package of flight, hotel and car rental. Ebookers concentrates on medium and long-haul trips—avoiding head-to-head competition with short-haul airlines, which themselves sell aggressively through their own websites. Ebookers' average transaction is £900 ($1,500), which Mr Dhamija says is high enough to involve more than just mouse clicks but also questions. Hence the need for a call centre.

Delhi helps provide a round-the-clock service along with offices in Europe. But what about local knowledge or language skills? That was the fear of ebookers' office in Finland, which trained some Finnish students and sent them to work in Delhi during their college gap year. The idea has now been expanded and 50 Europeans are working alongside the 600 Indian staff. More are on their way. It is the ability to answer questions by e-mail within a few hours—even on a Sunday evening—which is characteristic of the high level of service that Mr Dhamija is counting on to help ebookers stand out from the pack.

But Tecnovate, as the Delhi operation is called, does more than that. Along with clerical and financial duties, it also looks after IT. Mr Dhamija now hopes to turn Tecnovate itself into a profit centre by providing clerical, computer and call-centre services to hotels, airlines and other business partners. He is expanding its workforce to some 2,000 people. On October 2nd, a 6.3% stake in Tecnovate was sold for $10m to an investment group to help finance the growth.

On costs alone, Mr Dhamija says his Delhi back office saved £1.5m in the second quarter ending June 30th. Despite all the industry troubles, sales rose 67% to £118m. That was helped by the acquisition of Travelbag, a British firm that specialises in long-haul travel. It is being swiftly plugged into ebookers' computers. Only 16% of Travelbag's transactions were online in January; by September, this had risen to 46%.

Mr Dhamija gives an uncertain shrug about speculation that ebookers and lastminute may be takeover targets. Nevertheless, he concedes that the number of big European online agents could be whittled down to only two to three. Although his own company is listed on America's NASDAQ stock exchange as well as on London's stockmarket, he still owns 42%. Of course, there is a less pleasant route to consolidation than takeovers: price wars could drive some firms to the wall. This is why ebookers' Delhi operation is so important to its future. “If there is a market share battle,” says Mr Dhamija, “then it will be the company that keeps costs lowest that will be the last standing.”

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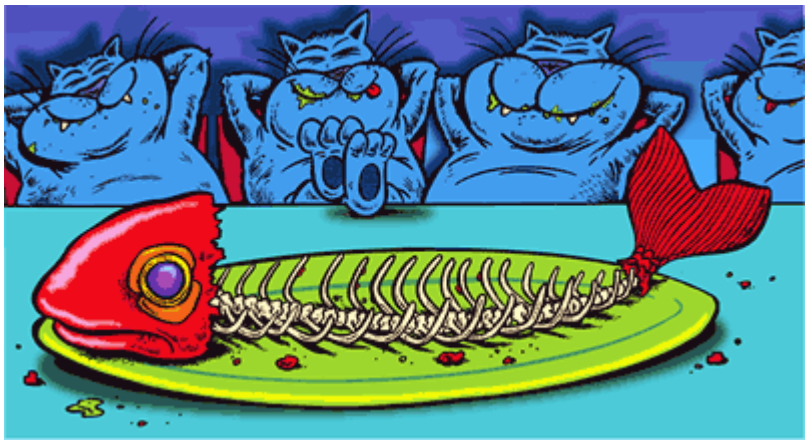
Executive pay

Fat cats feeding

Oct 9th 2003
From The Economist print edition



Why are company bosses being paid such large sums of money?

Get article background

NOTHING in business excites so much interest in the wider world as the pay of top executives. And this is never more true than when, as now, a few prominent cases prompt indignant headlines and rouse normally somnolent shareholders to action. The phenomenon is global. Last month Richard Grasso, chairman of the New York Stock Exchange, quickly went from folk hero, for the way he got the exchange running again after the terrorist attacks of September 11th, to the incarnation of corporate greed when it was revealed that he would be awarded $140m in accumulated benefits this year. Mr Grasso tried to stem the tide of outrage by agreeing to forgo another $48m due to him, but that appeased no one, and he was forced into an ignominious resignation.

A few days later it was the turn of Josef Ackermann, the Swiss boss of Germany's Deutsche Bank. He was charged with “breach of trust” and will stand trial in Dusseldorf early next year. His alleged crime was committed in early 2000 when he was on the supervisory board and the compensation committee of Mannesmann. The German mobile-phone company yielded to a bid from Britain's Vodafone, a takeover that it had initially contested. After the deal was agreed, a group of Mannesmann executives was paid bonuses of €57m ($53m).

The current trial in America of Dennis Kozlowski, the former boss of Tyco, on charges of plundering the public company that employed him of hundreds of millions of dollars has rekindled in the public's mind the idea that extraordinarily high levels of executive pay are tangled up with corporate shenanigans and illegal activity. But that is not necessarily the case. There has been no suggestion that Mr Grasso broke the law, nor that Mr Ackermann, who is indeed accused of breaking a law, benefited personally from the bonuses that were handed out to Mannesmann's executives.

Independence on board

Few bosses these days need to resort to skulduggery to receive fat cheques. For the most part, their employers are persuaded to sign legally binding contracts which hand them large sums of money with few questions asked. They are a bit like medieval knights granted great tracts of land by grateful monarchs. It was always too much to expect them to say, “Thank you, milud, but the little cottage by the main gate will do me nicely.” Or, indeed, at some later date to suggest: “Since I just lost that battle,

here's half my land back."

Media mentions of "fat cats" and pay have been rising sharply—up by 60% in the first nine months of this year on the same period in 2002. Executive pay has taken over as the top concern of corporate governance from last year's biggest worry, the independence of auditors. Governments and regulators are becoming increasingly interested in the issue. Under pressure from institutional investors, America's Securities and Exchange Commission (SEC) this week proposed rules that will make it easier for shareholders to nominate candidates to a company's board. Investors hope this will lead to the greater independence of directors who, in the end, decide how much their company's chief executive officer (CEO) should be paid.

In June, the British government issued a document inviting comments on how to control one aspect of CEO remuneration—the granting of large severance payments when bosses' contracts are terminated, regardless of how their company has performed. "Rewards for failure for a small minority", says Patricia Hewitt, Britain's secretary of state for trade and industry, "damage the image and reputation of the whole of British business." The government has received more than 100 responses to its paper and hopes to produce proposals on the issue within two months.

By and large, governments are reluctant to intervene in the private matter of employment contracts. A British parliamentary inquiry into the subject of paying bosses large amounts even when they fail reported last month that it would prefer the government to give industry's own initiatives on the subject time to work rather than to impose new laws. But trade unions and many shareholders are eager for governments to take action. In Britain, the Trades Union Congress, the unions' national body, wants to reduce the notice given to dismissed senior executives, which can often be as long as two years. "An upper limit of six months should be a legal requirement," it says, to bring the treatment of executives more in line with the three months that is normal for other British employees. The AFL-CIO, which represents most unions in America, is pushing for legislation to curb executive-only pensions that give a chosen few guaranteed above-market rates of return.

Soft landings, hard questions

So-called "golden parachutes", large pay-offs even when top executives fail, have become a main focus this year in the debate over executive pay. The Corporate Library, a shareholder watchdog in America, reckons that the average departing CEO in that country receives a severance package worth $16.5m. In May this year, shareholders at the annual general meeting of GlaxoSmithKline (GSK), the world's largest pharmaceuticals company, revolted against the severance pay promised to its boss, Jean-Pierre Garnier, if he were forced to leave the company prematurely. Since one of the more likely reasons for such a departure would be poor performance, shareholders deemed the $35.7m farewell gift to be excessive. Under new rules allowing shareholders to vote each year on British firms' executive-compensation plans, GSK's owners gave Mr Garnier's golden parachute the thumbs down.

The vote sent a jolt through corporate Britain, and was hailed as a landmark in corporate governance. Yet it did not actually change Mr Garnier's compensation package. The vote is only advisory. Sir Christopher Hogg, the chairman of GSK, points out that the company (aided by Deloitte & Touche) was already undertaking a review of its remuneration policy before the vote took place. That review is still going on and Sir Christopher says that whatever the outcome, "we will be seeking shareholders' endorsement...at the AGM in 2004." He has written to the Association of British Insurers to say that "the board has registered shareholders' particular sensitivity to payments on termination, whether contractual or ex-gratia."

British union leaders want shareholders' votes on executive pay to be made binding. And they want shareholders to register more concern about the issue. Despite all the fuss over Mr Garnier, GSK remains the only company in Britain this year whose remuneration report failed to meet with its shareholders' approval.

In France, the tide of sentiment against rewards for failure helped persuade Pierre Bilger, a former chief executive of Alstom, to hand back in August the €4.1m severance package granted to him in March when he stepped down from the troubled French engineering group. He did not, he said, "want to be cause for scandal among the 100,000 Alstom employees whom I had the honour to direct for 12 years"—until, that is, the company had to be rescued by the French government. Mr Bilger's example has not yet been followed by his compatriot Jean-Marie Messier, the former boss of Vivendi Universal. He is still fighting to retain the €20.5m severance package due to him after he was sacked.

Yet golden parachutes and severance pay are only one part of executive compensation. They have been the main focus in recent months. But that is only because the previous mechanism delivering big payouts—namely, share options—came under such hostile scrutiny. Chief executives are selected for their cleverness and determination, and they have directed these qualities at boosting their own pay. The more the public spotlight is thrown on one aspect of bosses' remuneration, it seems, the more it rises elsewhere.

The amounts awarded through share options in recent years dwarf those paid out by golden parachutes or by any other mechanism. Even in 2001, after the stockmarket bubble had burst, the value of stock options granted to the CEOs of S&P 500 companies, America's largest, rose by 43.6% in a year when the total returns from those companies fell by almost 12%.

The immense and random windfalls that stock options can bring has aroused the anger of shareholders and the general public alike. Last year, for example, Jeffrey Barbakow, the chief executive of Tenet Healthcare, a hospital-management business in California, received $111m from exercising his stock options in a year when the company's share price fell by nearly 60%. After a group of shareholders led by a Florida doctor threatened to remove him, Mr Barbakow resigned last May.

Share options give rise to a phenomenon known as “pump and dump”, whereby top executives do everything they can to pump up their company's share price in the short term (including, in notorious cases such as WorldCom, fiddling the company's accounts) so that they can dump their options and maximise their personal gain.

They also, in effect, dilute shareholders' equity with nary a by-your-leave. According to the Investor Responsibility Research Centre in America, the average percentage of companies' shares that was promised as share options reached a record 15.7% in 2002. In some significant cases, it exceeded 25%. It has been a fundamental tenet of shareholder capitalism for decades that there should be no dilution of equity without the prior approval of the company's existing shareholders. Share options drove a coach and horses through that principle.

Once the options trend slowed, bosses reverted to cash to swell their remuneration. In 2002, the median cash bonus of S&P 500 CEOs rose by 8.8% after falling the previous year, according to figures prepared for CalPERS, the largest public pension fund in America. The value of CEOs' stock-option grants in 2002 fell by 18.6%, having risen by 43.6% the year before.

A number of companies are now rewarding their top executives with stock rather than stock options. Trevor Fetter, Mr Barbakow's successor at Tenet Healthcare, was granted two shares in the company for every one that he purchased, up to a limit of 200,000. Many such awards of shares are in the form of “restricted stock”, which the executive is not allowed to sell for a specific period. This retains the link between reward and the company's share price, but removes most of the opportunities to pump and dump.

Another method of showering bosses with rewards which surfaced in 2002 has been pension packages. These first hit the headlines with Jack Welch's divorce settlement. The estranged wife of the former boss of General Electric pointed out to the divorce courts that Mr Welch's retirement package did not just include a generous pension, but also entitled him to the use of GE's corporate jets, help with his $80,000-a-month Manhattan apartment, and a regular supply of fresh flowers.

Then the bosses of American Airlines, struggling from set-backs in the air-travel business following September 11th, were revealed to have placed $41m in a pension fund for themselves that was fully protected should the company go into Chapter-11 bankruptcy. This self-appointed perk remained hidden until after negotiations with the airline's unions aimed at securing wage concessions of up to $2 billion had ended a few months later.

Loans granted and then forgiven are another popular way of enriching CEOs. Charles Conaway, the chief executive of Kmart, an American discount retailer, left the company in March 2002 after just 21 months in the job and two months after the company had filed for Chapter-11 bankruptcy. A company loan of $5m, granted as part of Mr Conaway's pay package, was “forgiven” upon his departure.

Robert Nardelli, one of two candidates who failed to win the top job at General Electric on Mr Welch's retirement, left to head Home Depot, a retailer with revenues less than half those of GE. Mr Nardelli's compensation in 2002 (of around $20m) included $2.5m for the forgiveness (to be spread over four years) of a $10m loan granted to him on his appointment. His contract also forgives him any interest on the loan and any tax due, and it includes a golden parachute of at least $20m. Not bad for an also-ran.

The spotlight rarely falls on the basic salaries of top executives because these do not tend to rise at such a dramatic rate. In 2002, the median base salary of the CEOs of the S&P 500 companies was $925,000. The median total compensation for that year, on the other hand, was $3.65m.

It has become almost fashionable these days for bosses to forgo their basic pay. Eli Lilly's boss Sidney Taurel took a salary of only $1 in 2002. John Chambers of Cisco Systems did likewise, and Larry Ellison, boss of Oracle, took a dollar less. Nevertheless, in 2001 Mr Ellison had been the highest paid executive in America thanks to $706m garnered from stock options he exercised that year.

Scratch and scratch alike

How do CEOs manage to get themselves these handsome contracts? Warren Buffett, the chairman of Berkshire Hathaway and one of America's shrewdest commentators on corporate governance, says in his most recent letter to his shareholders that “the answer lies not in inadequate laws...but rather in what I'd call ‘boardroom atmosphere'.”

The “you scratch my back, I'll scratch yours” atmosphere of company boardrooms has been recognised for decades. As Mr Buffett describes it, “when the compensation committee—armed as always with support from a high-paid consultant—reports on a mega-grant of options to the CEO, it would be like belching at the dinner table for a director to suggest that the committee reconsider.”

Last week, the *Wall Street Journal* reported that Mr Grasso had tried to persuade a NYSE market-maker to commit more money to the market in the shares of AIG, America's biggest insurance company. Mr Grasso had received complaints about the market-maker from Hank Greenberg, the chairman of AIG. Mr Greenberg happened to sit on the NYSE compensation committee responsible for Mr Grasso's employment contract.

The back-scratching is made more effective because it is exercised within a relatively small circle. Fifteen years ago a book called “Les 200” caused a stir in France by tracing the connections between the 200 individuals who, in effect, ran French big business. In America, where the population and the economy are so much bigger, this network is much larger. Research by The Corporate Library, however, suggests that even in America today a small number of individuals link with each other across the boards of the country's biggest companies. And they compare notes.

In a report published in September, The Corporate Library claims that the best-connected board in America is that of J.P. Morgan Chase (see table). One of the bank's directors, William Gray, president of the United Negro College Fund and the first black American to chair the House of Representatives' budget committee, has the most S&P 500 company directorships of anybody (eight). Apart from J.P. Morgan, he is on the board of Dell, Pfizer, Rockwell Automation, Viacom, EDS, Prudential Insurance and Visteon. These eight firms have an annual turnover of $186 billion.

A boss's remuneration is largely determined at the time of his appointment, which follows a fairly standard procedure. At Motorola, whose CEO Christopher Galvin resigned on September 17th, a search committee was appointed immediately after the resignation was announced. Under the chairmanship of John Pepper, a director who was once the boss of Procter & Gamble, it includes Larry Fuller, a former boss of Amoco, and Douglas Warner. Mr Fuller is a director of J.P. Morgan Chase and a member of America's best-connected board. Mr Warner is a former chairman of the board of J.P. Morgan Chase who now sits on the compensation committee of General Electric.

Well connected

Directors of J.P. Morgan Chase

Hans W. Becherer	Ellen V. Futter
Riley P. Bechtel	William H. Gray
Frank A. Bennack, jr	William B. Harrison
John H. Biggs	Helene L. Kaplan
Lawrence A. Bossidy	Lee R. Raymond
M. Anthony Burns	John R. Stafford
H. Laurance Fuller	

Other companies of which at least one of the above is a director:

Abbott Laboratories; American International Group; Bechtel; Black & Decker; Boeing; Bristol-Myers Squibb; Dell Computer; Electronic Data Systems; Exxon Mobil; Hearst; Honeywell; J.C. Penney; May Department Stores; Merck & Co; Metlife; Motorola; NYSE; Pfizer; Polo Ralph Lauren; Prudential Insurance Company; Rockwell Automation; Schering-Plough; Verizon Communications; Viacom; Wyeth

Source: J.P. Morgan Chase Proxy statement, March 2003

Selection process engineering

One of the first things that the Motorola search committee did was to follow the standard procedure of selecting a recruitment consultant to help them—in their case, the well-established firm of Spencer Stuart. To determine what a new CEO's salary should be, consultants make use of benchmarks. For Tenet Healthcare's new boss, for example, the comparison was with “compensation levels and opportunities made available to executives at the company's peer companies”.

This has the effect of continually ratcheting up bosses' pay. No selection committee wants to award their new choice less than the industry average. That will, they feel, not attract the best man to the job, and it will also suggest that their company has settled for someone less than average. Since the tenure of top bosses is getting shorter and shorter, this ratcheting effect is accelerating, especially in Europe where, according to a recent report from consultants at Booz Allen Hamilton, the turnover of top CEOs has almost tripled since 1995.

Warren Buffett said recently, “It would be a travesty if the bloated pay of recent years became a baseline for future compensation. Compensation committees should go back to the drawing board.” But it is not easy to see who will be brave enough to fight the benchmarking trend. One feature of the recent scandals over executive pay may help: the finger is now being pointed more directly at those who agreed to extravagant contracts in the first place. Carl McCall, a former UN ambassador, and Jürgen Schrempp, the boss of DaimlerChrysler, resigned from the board of the NYSE shortly after Richard Grasso left because of the brouhaha surrounding his pay. And Josef Ackermann is going to court for no other reason than that he nodded through handsome golden parachutes for some Mannesmann executives.

If members of compensation committees were more regularly held to account for the contracts which they approve, it seems likely that fewer of those contracts would be offensive to employees, shareholders and the general public.

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Interest rates

Time to go up?

Oct 9th 2003
From The Economist print edition

Alamy

Signs of economic recovery are mounting—and with them expectations that interest rates are about to rise. Yet central banks should not hurry to tighten policy

MONETARY policy has rarely been so loose. Short-term interest rates are at their lowest level for almost half a century. Even in real terms—ie, after adjusting for inflation—the average interest rate in the G7 economies is negative for the first time since the 1970s, when inflation soared. Have rates now hit the bottom? And if so, how long will it be before they start to rise?

Financial markets are betting that the next moves in interest rates will be upwards. The futures market is implicitly forecasting that American interest rates will rise from 1% now to 1.5% by next June and to 2.3% by December 2004. Euro-area rates are expected to rise from 2% to 2.8% by the end of next year. The market predicts that the Bank of England, which left interest rates unchanged on October 9th, will increase them by almost half a point by the end of 2003. Only in Japan are rates tipped to stay unchanged, at zero.

The markets reckon that global growth is speeding up, so central banks will soon need to lift interest rates to hold inflation down. In previous cycles, central banks have typically lifted rates within two years of recession's end. Technically, America's recession finished in November 2001.

The flaw in this argument is that this economic cycle is not typical. Thanks to a post-bubble hangover, America's recovery has been the slowest in modern times: annual GDP growth has averaged 2.7%, compared with 4.7% during the first two years of the previous eight recoveries. Employment rose, on average, by 4% in the first two years of previous recoveries, but since November 2001 employment in America has continued to fall. Industry is using less than 75% of its capacity, compared with almost 80% at the same point of previous cycles. Thus, even if the economy grows rapidly over the next year or so (and it may not), there will still be plenty of slack, putting further downward pressure on inflation.

At the end of previous recessions, inflation was also much higher than today, so as growth perked up monetary policy needed to be tightened swiftly to stop inflation rising. Today, America's inflation rate is uncomfortably low. Core consumer-price inflation (ie, excluding energy and food) fell to a 37-year low of 1.3% in the year to August, and it could dip lower next year. At the very least, the Federal Reserve is likely to tighten policy more slowly than in past recoveries. Indeed, Ben Bernanke, a governor at the Fed,

argued recently that when there is considerable economic slack, if output growth is generated solely by increased productivity, with no expansion in jobs, then monetary policy may have to be eased, not tightened, to guard against the risk of inflation falling too low.

Similar arguments apply in the euro area. In the first half of this year, output stalled in the euro area, and Germany and Italy slipped back into recession. Until recently financial markets had therefore expected interest rates to fall further. But more recent data suggest that recovery is under way, so the markets are now betting that the European Central Bank could start lifting rates early next year. That would surely be premature if, as many forecasters expect, inflation falls next year. Much will depend on the euro. This week it rose to within a whisker of its record high against the dollar, but in trade-weighted terms it is still 2% below its level in June, before the ECB last reduced interest rates. If the euro climbs higher in trade-weighted terms, cramping growth and helping to squash inflation, then an interest-rate cut would be more likely than an increase.

The likely first mover

The Bank of England will probably be the first big central bank to lift rates. Britain has the highest inflation rate of any of the big seven economies (2.9%) and economic growth has been more robust than expected. Recently revised figures showed that, in the first half of 2003, GDP grew twice as fast as previously thought. Some members of the bank's Monetary Policy Committee have also been expressing concern about rampant consumer borrowing and surging house prices.

Japan still has deflation (falling prices), yet even there the debate about when interest rates will rise is hotting up, largely because expectations about GDP growth have become markedly more optimistic. *The Economist*'s monthly poll of forecasters now expects growth this year and next to average 2.2%, well above most estimates of Japan's sustainable potential rate of 1-1.5%. There are also signs that deflation is abating: consumer prices fell by only 0.3% in the year to August. The Bank of Japan has said it will maintain zero interest rates until inflation turns positive.

But a month or two of rising prices is unlikely to make the central bank jump. Its governor, Toshihiko Fukui, has said: “We will continue with our policy not only until prices rise but until there is no fear that they will fall again.” Last week Kazumasa Iwata, a deputy governor, went further. He said he viewed “price stability” as inflation of 1-2%, implying a longer period of zero interest rates.

The recent easing of deflation is also partly due to special factors, such as an increase in cigarette tax. Richard Jerram, an economist at ING bank, estimates that underlying deflation is running at 0.5% and has not fallen significantly during the past year-and-a-half of recovery. He expects interest rates to remain at zero for a long time.

A significant rise in interest rates by the main central banks is unlikely over the next year as long as inflation remains low. A few economists concur: those at Goldman Sachs do not expect the Fed to raise rates before mid-2005. Given Japan's grim experience, this seems wise insurance against deflation.

Yet an easy monetary policy is not without its dangers. The build-up of excess liquidity in recent years, as central banks have become serial bubble-blowers, is a growing cause for concern. As one bubble after another has burst, from Asia to tech stocks, central banks have eased policy time and again. By slashing interest rates after the stockmarket bubble burst, America's Fed prevented a deeper recession and staved off the risk of deflation, but at the cost of encouraging ever higher consumer borrowing—and hence the risk of an even bigger blow to growth when interest rates eventually have to go up.

Divers who stay deep down in the ocean for too long risk getting “the bends” when they ascend. Are central bankers risking a similar fate?

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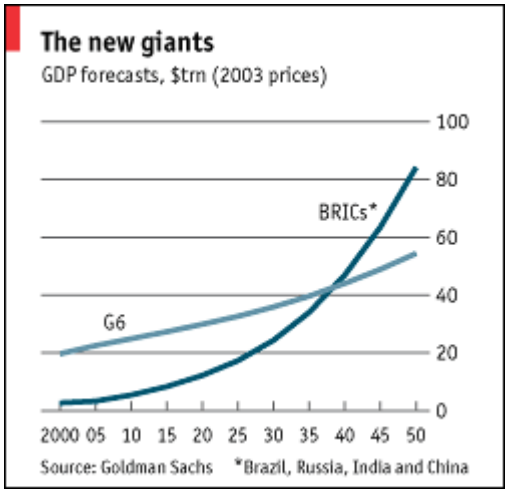
Global economic rankings

Follow the yellow BRIC road

Oct 9th 2003
From The Economist print edition

Welcome to tomorrow's economic giants



CHINA'S economic policies are under increasing attack from the rich, G7 countries. Yet China can console itself with the fact that within half a century, not only is its economy likely to be bigger than any of the G7 (America, Japan, Germany, France, Britain, Italy and Canada), but most of the current G7's members are unlikely to be eligible to attend meetings of the world's biggest economies. For China is not the only emerging economy moving up the pecking order.

A new study by Goldman Sachs focuses on the so-called BRICs (Brazil, Russia, India and China). Today their combined GDP (at market exchange rates) is one-eighth of the output of the G6 (Goldman leaves out Canada, which accounts for only 3% of the G7's GDP) But the study concludes that the total output of the four economies will overtake that of the G6 in less than 40 years. Of today's G6, only America and Japan would then still be among the world's six biggest economies.

This prediction is not based on a crude extrapolation of growth rates. Instead, the authors make assumptions about population growth, the pace of investment, productivity growth and currency movements. These imply that, even if the BRICs stick with sensible economic policies, their future growth rates will slow significantly.

China is tipped to overtake Germany by 2007, Japan by 2015 and America by 2041. India could overtake Japan by 2032. All four BRICs will be bigger than any western European economy by 2036. For firms looking where to invest, the most striking result is that, by 2009, the annual increase in total dollar spending in the BRICs could be greater than that in the G6. By 2025, spending could be increasing twice as fast in the BRICs.

Such long-term forecasts are almost bound to be wrong, not least because governments may make mistakes or political instability may intervene. Even so, this is a useful framework for understanding the rise of the emerging giants.

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European financial markets

The City grumbles

Oct 9th 2003 | BRUSSELS
From The Economist print edition

London bankers complain about proposed European share-trading rules

PAUL BOATENG, a British Treasury minister, this week condemned as “misguided and profoundly anti-competitive” the latest proposal from the European Union for regulating financial markets. He said it would damage the City of London's way of doing business, increase the cost of capital and put Europe at a disadvantage to American rivals. Mr Boateng cited a study which estimates that the proposal would raise the cost of share trading outside stock exchanges by €450m ($530m) a year.

It would seem that London and Brussels have profoundly different views of how financial markets can and should be regulated. The European Commission wants to replace the current, ten-year-old, ineffective law on investment services, itself an unhappy compromise, with a new version which would harmonise regulatory regimes across the 15 (soon to be 25) states of the EU. The aim is to break down barriers to cross-border trading, in pursuit of a single financial market across the EU.

On October 7th the commission's proposal cleared another legislative hurdle when a majority of finance ministers approved the latest draft. The commission is anxious to get the European Parliament to pass the law before the end of its five-year term next summer. France and Italy are its staunchest supporters; Britain, in alliance with four other countries, its fiercest critic.

The City broadly supports the aim of harmonising regulatory regimes. The existing law is a failure because it allows national governments to impose domestic regulatory burdens on financial-services firms from other EU states. But the City is balking at greater regulation of “off-market” transactions, which is the price that must apparently be paid for creating a common European regulatory regime.

Off-market trades are common in London, where investment banks do deals for professional clients, matching buy and sell orders without going through the stock exchange. The big banks in Frankfurt conduct similar transactions. But in France, Italy, Spain and Greece such deals have up to now been all but forbidden. National regulatory regimes have demanded that shares be traded through an exchange.

Any such requirement will disappear under the new EU law. However, to allay concerns in southern states with less developed financial markets that investors who trade off-exchange might be vulnerable to being ripped off, the commission is proposing that there should be pre-trade transparency: investment banks would have to make firm quotes public ahead of a trade. This requirement will only be lifted for transactions above a certain size, all parties to which are assumed to be sufficiently savvy. The investment banks protest that this is too great a regulatory burden: the obligation to honour pre-trade prices runs counter to the need to adapt to market circumstances. They conclude that European banks will be deterred from entering each other's markets, and thus that the law will not achieve its purpose.

The London investment bankers claim they will lose out to competitors outside the EU, as well as to the stock exchanges. They say revealing certain types of large order to the market before execution will move prices against investors. The exchanges and their allies are successfully fighting back against the idea of a light regulatory touch. Expect another round of loud lobbying before the European Parliament votes in a few months' time.

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America's mutual funds

The scandal spreads

Oct 9th 2003
From The Economist print edition

A wave of suspensions and sackings hits a $7 trillion industry

“THE full extent of this complicated fraud is not yet known,” said Eliot Spitzer, New York state's attorney-general, when he launched an investigation into mutual-fund fraud on September 3rd. A month on, it still isn't. The industry, which oversees $7 trillion of Americans' assets, is fighting for its reputation. Several dozen class-action lawsuits have already been filed. Mutual funds and their investors are wondering what Mr Spitzer's probe, and another by the federal Securities and Exchange Commission (SEC), will unearth.

So far one of the four firms cited in Mr Spitzer's original complaint, Bank of America, has fired three employees. Another, Strong Capital, said late last month that it would make “appropriate reimbursements” to clients if an internal review finds they have been harmed. Merrill Lynch, Prudential and Alliance Capital have also fired or suspended staff. Following a second complaint by Mr Spitzer, on October 2nd a former trader at Millennium Partners, a hedge fund, pleaded guilty to securities fraud. The chief executive of Security Trust, another company the attorney-general is after, resigned on October 6th. Others have received subpoenas from Mr Spitzer.

Like investment banks, with which Mr Spitzer reached a settlement in April, mutual funds have long been known to have potential conflicts of interest. On the one hand, fund managers' earnings are related to how much money they manage. On the other, their quest for size can sometimes clash with the financial interests of their investors. Although they have a fiduciary duty to investors, they stand accused of breaching it.

Market timing and late trading, the two practices currently under scrutiny, are litmus tests of fund managers' loyalties. Market timing exploits inefficiencies in the way the prices of shares in mutual funds are derived from the prices of underlying securities (such as shares in listed companies). The value of a mutual fund does not change in the course of a day: its shares are bought or sold at a price fixed by the fund's manager, who also acts as the primary market maker for the fund's own shares. Fund prices are usually fixed at the end of the previous trading day. Thus an American manager whose fund specialises in Japanese shares uses stale closing prices from Tokyo, established 14 hours before trading ends in New York, to fix the value of his own fund. If market moves in America suggest a sunny outlook for the next day in Japan, a market timer, usually a professional trader, can buy the mutual fund at the fixed price, reflecting stale Tokyo prices, and then sell the fund's shares back to its manager the next day at a profit.

This is not illegal. But it hurts long-term mutual-fund investors, because the market timer's quick sale reduces the fund's asset value and imposes transaction costs on the fund. Yet fund-management firms are tempted to allow market timing by traders who promise to throw more business their way in the future. The practice becomes legally murky when mutual funds say in their prospectus, as most do, that they act to prevent timing, but still allow the practice. Some firms explicitly say that they accept or even invite market timing.

Late trading is tempting for mutual funds for the same reason: if fund managers allow it, late traders will put more business their way. Helped by friendly fund managers, late traders place buy or sell orders after the value of a fund has been set at the end of the trading day. They can then profit from news about companies whose shares are held in the fund. This is prohibited by federal securities law, but can go unnoticed if traders and fund managers cover their tracks.

The scandal is prompting investors to question whether mutual funds are acting in their interest. No individual is likely to have lost much, yet the collective sum is large. William Goetzmann of Yale University estimates that in the 17 months to June 1998 trading on stale prices in 116 mutual funds cost investors 0.44% of the funds' assets, or $1.5 billion. This shaving of returns might not be spotted during

a bull market. In a bear market, where gains are harder to come by, investors are more sensitive.

Regulators are now seeking ways of straightening out mutual funds' allegiances. In testimony to the Senate banking committee last week William Donaldson, chairman of the SEC, said that the agency will demand more transparency on funds' expenses and commissions, and more information on their policies on market timing. The SEC will probably recommend that mutual funds adopt “fair-value” pricing: instead of actual, stale prices, mutual funds would price Japanese stocks, say, according to what they think their value should be after New York's trading day. If funds did not use fair-value pricing, they would have to explain why.

However, fair-value pricing may also be open to abuse, because of its subjectivity. Indeed, until recently the SEC itself was disinclined to advocate fair-value pricing, on the ground that it involved “complicated judgment calls”. Even with fair-value pricing, investors would have to rely on simple faith that mutual funds were not breaching their fiduciary duty. The coming months will show whether fund managers deserve Americans' confidence.

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Japanese banks

Rising

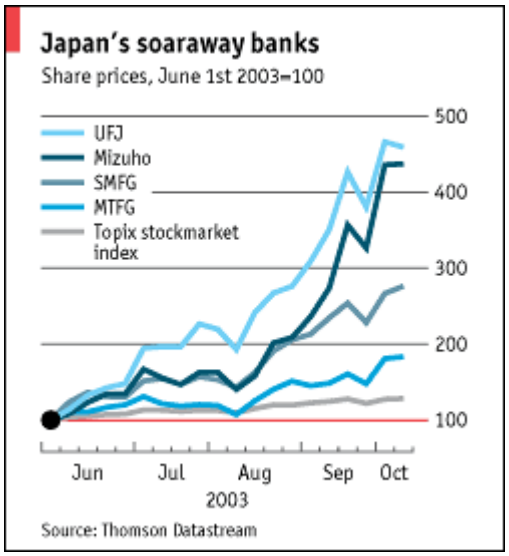
Oct 9th 2003 | TOKYO
From The Economist print edition

But not resurrected

Get article background

NOT for the first time, the message from the stockmarket looks clear. Japan's sickly banks are at last on the mend. The price of shares in Mizuho, the biggest, jumped by a third in two weeks, and is now five times its record low, set in April. The next three—Sumitomo Mitsui Financial Group (SMFG), Mitsubishi Tokyo Financial Group (MTFG) and UFJ—have enjoyed similar leaps. Even Resona, the number five, which received ¥2 trillion ($17 billion) from the government in May (and still thinks it lost ¥1 trillion or more in the six months to September 30th), has seen its share price triple since the bail-out.

Resona's rescue, which cost shareholders nothing, signalled that the government would not let any top banks (or big borrowers) collapse. It sparked a general stockmarket rally, helped along by evidence of economic recovery in Japan, though it was no surprise that banks thought too big to fail proved especially popular. First, foreign institutions bought; then locals switched from bonds to equities. Investors who were late to the rally seem to have given bank shares an extra fillip, buying them because their ups and downs amplify those of the economy. As the yen has climbed recently, bank shares have done well again, as investors have turned away from exporters and towards domestic stocks, such as banks and retailers.



In addition, banks have been making rosy profit forecasts for the half-year ending on September 30th. MTFG has almost quadrupled its net profit forecast, to ¥270 billion. On October 6th, Mizuho raised its estimate from ¥100 billion to ¥230 billion. Two days later, SMFG revised its forecast from ¥80 billion to ¥130 billion. UFJ is expected to follow suit.

Banks made big profits by selling bonds in the spring. Now that the stockmarket has risen, they can count unrealised share-price gains too. Their profits also include one-off tax refunds from the Tokyo city government. MTFG and Mizuho say that the mild economic upturn seems to have helped stem the flow of bad loans. MTFG has even cut its general reserves against loans to weak borrowers, on the assumption that the improving economy will have helped their finances.

Despite all this, there are good reasons for caution. Jason Rogers, of Barclays Capital in Tokyo, gives warning that Japan's banks have merely moved back from near crisis a year ago to a more even keel. Their operating environment remains weak. Land prices are still falling and bankruptcies are still high. Arguably, says Mr Rogers, the health of the small and medium-sized businesses that make up 70% of banks' corporate loans is continuing to deteriorate. Hironari Nozaki of HSBC Securities points out that loan demand remains weak, banks are charging too little interest, given the risk, and banks' fee-based businesses are barely growing.

Although bad loans are being disposed of more speedily, their quantity remains enormous. What is more, much of the recent reduction in bad debts is accounted for by the forgiving of some loans to big, “zombie” firms. Instead of removing the living dead from their books, banks continue to support them with credit lines or fresh loans, which analysts think will probably turn sour in a couple of years. The fact that Resona's new management seems to have discovered another ¥1 trillion or so of bad loans since

May is one sign that Japanese banks' difficulties are far from over.

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Tech stocks

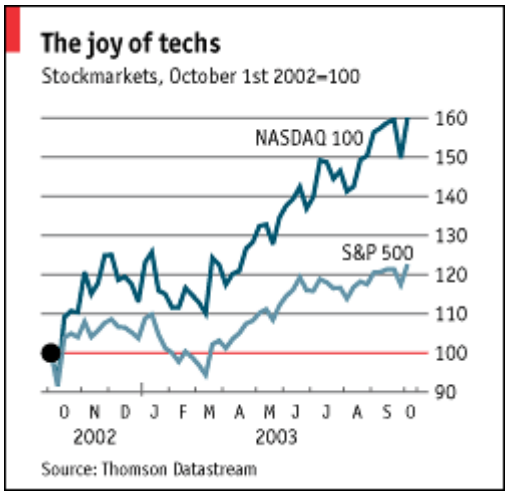
They're back!

Oct 9th 2003
From The Economist print edition

To earthbound investors, the three scariest letters are T, M and T

ON OCTOBER 8th, Yahoo!, an internet-portal company, announced third-quarter results roughly in line with what investors had expected, which is to say they were quite good. It made net profits of $65.3m, compared with $28.9m a year earlier. But then it needed to. At current prices and profits, shareholders will have to wait 100 years or so to get their money back.

Shares in Yahoo! and many others in the disparate group dubbed TMT (for technology, media and telecoms) during the go-go 1990s, have again been rising by eye-popping amounts. The NASDAQ composite index, the repository of high-techery, has risen by 70% over the past 12 months; the smaller NASDAQ 100 has climbed by 73%. Shares on the NASDAQ stockmarket now have a price-earnings (p/e) ratio, on next year's profit forecasts, of 39. For this to be at all justifiable, either profits will have to rise by an awful lot or share prices will have to fall by an awful lot. Quite possibly, profits will go up by a fair (but not spectacular) amount, enough to drive share prices to even sillier levels before reality dawns on investors.



The rise has not been confined to America. Telecoms and technology stocks (media is out of favour these days) have been racing up in Europe and Asia, too. Shares in Ericsson, a once-troubled telecoms-equipment manufacturer, have rocketed some 250% since their low; the telecoms and technology sectors in the Dow Jones Euro Stoxx index are up by 37% and 54%, respectively. Japanese tech stocks have been soaring as well, led by two old bubble favourites, Softbank, an internet conglomerate (up 500% from its low) and Hikari Tsushin, a mobile-phone vendor and internet incubator (up 650%).

Signs that the market might again be a little frothy come not only from the vertiginous rise, giddy valuations and punters' enthusiasm for the likes of Softbank, which at one point last week was the mostly highly traded stock on the planet. In America, more people are buying stocks on margin (in other words, borrowing from their brokers to buy shares) than in March 2000, when the last bubble burst so spectacularly. Worrying too is the widespread view that profits cannot but pick up because technology firms have cut costs so sharply and because customers have put off spending for too long on technology.

There is something to this argument. According to Challenger, Gray & Christmas, an outplacement firm, some 470,000 jobs were cut last year in technology companies. But the pace has slowed because technology spending started to pick up in the fourth quarter of last year; indeed, in America corporate spending on information technology is rising faster than spending on anything else. Driven by leaner operations and higher demand, profits are rising. The consensus among analysts is that profits will rise by 26% this year for Dell Computer and 233% for Amazon.com. For NASDAQ as a whole, analysts think that profits will rise by a quarter.

It would, however, be rash to assume a return to the heady spending of the 1990s. For one thing, companies are now much more concerned about the state of their balance sheets, and so more careful about their technology spending. And there are deeper reasons for worry. Technology stocks are astonishingly risky, as investors should have learned. In the past 12 months, one-third of the world's tech stocks fell by a fifth or more on at least one day. Companies are unlikely to last long. Almost none of the big technology companies of 20 years ago still exist, points out Fred Hickey, the editor of the *High-*

Tech Strategist, a newsletter. “You cannot be a long-term technology investor because in the long term almost all of the stocks are dead,” he says.

It used to be that investors demanded to be rewarded for this risk. In the seven years to 1996, Mr Hickey points out, Dell increased its sales 20-fold, to $7.8 billion. Its p/e ratio never exceeded 13. Now it is a fairly mature company struggling to grow by 15% a year and its stock has a p/e of 37. “Go figure,” says Mr Hickey.

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Economic development

Poverty's chains

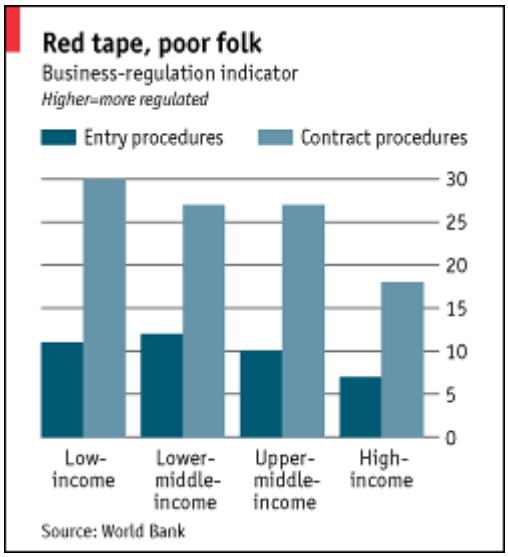
Oct 9th 2003
From The Economist print edition

A new report gives governments some facts to ponder

FOR a better understanding of the plight of the world's poor, the protestors against capitalism who descended on the World Trade Organisation's meeting in Cancún last month ought perhaps to have gone to Haiti instead. They might have followed a would-be entrepreneur trying to open a small business. If, that is, they had six months to spare.

In Haiti, one of the world's poorest countries, prospective business people have to wait an average of 203 days for permission to start trading. Then they have to pay registration costs and satisfy minimum capital requirements of around four times the average Haitian's annual income. Other countries are as bad. In the Democratic Republic of Congo, it takes even longer to unwind red tape. Set-up costs, including capital requirements, amount to around ten times average income. In Belarus, costs are lower, but budding entrepreneurs must endure 19 separate paper-pushing exercises. At every step, there is a chance of falling prey to corrupt officials.

The juxtaposition of stifling bureaucracy and abject poverty is no coincidence, argues a new report, “Doing Business in 2004”, by the World Bank. It offers one of the first consistent, rigorous portraits of the costs of business regulations in poor countries. One lesson jumps out of the data: the more heavily regulated a country's business environment, the likelier it is to be poor (see chart). The report says that developing countries are choking off one of their best avenues towards wealth creation: local business.



It also offers a healthy balance to the usual debates about the merits and demerits of capitalism. These often concern macroeconomic questions such as monetary policy and fiscal discipline, and the means of globalisation, such as free trade and foreign investment. Yet the report shows how poor countries' governments often tie their own people down in a thicket of useless regulation.

The struggles in starting a new firm are only the first of many burdens. Many poor countries provide legal protection for workers that rivals that in the most welfare-minded western European countries. Guatemala, for example, mandates 20 months' severance pay for its workers. Other countries forbid most types of short-term contracts and set high minimum wages. But this is “protection” only in name: such labour-market rigidities are strongly correlated with high poverty rates, since businesses can rarely bear the heavy costs. Moreover, the cost of these regulations falls disproportionately on women and the unskilled young, who are often excluded from employment or driven into the informal economy, where they have no rights at all.

Many countries also do a lousy job in enforcing contracts and property rights, notes the report. Providing credit to small business in the developing world is difficult, thanks to the paucity of credit bureaus. After closing a business in Brazil or India, it may take a decade for legal wrangles to subside. No wonder that many believe the costs of starting a business are simply too great.

Reforming such regulations, however, need not mean an end to social supports. The Nordic countries, for example, manage an enviable welfare state. Canada, home of state-funded medical care for all, nonetheless lets entrepreneurs register a business quickly and online.

The World Bank has sometimes been criticised for imposing the values of rich countries on poor people. This report makes clear that many business regulations in developing countries are, in fact, the legacy of colonialism and thus of European legal systems, rather than of public choices made by local citizens. Countries such as Haiti which, through colonialism, inherited laws from the French legal system are especially prone to red tape. By and large, a tradition of English common law leaves a freer hand for business—although India is a glaring exception.

Some progress has been made in reducing regulatory burdens, especially in Latin America, but much more needs to be done. As long as regulations enrich local bureaucrats and lawyers, would-be business people in countries such as Haiti will have to keep waiting.

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Economics focus

Soft science no more

Oct 9th 2003
From The Economist print edition

This year's Nobel prize shows how far number crunchers have come in economics

ONCE, a beautiful turn of phrase would take you a long way in economics. From Adam Smith to John Maynard Keynes, economists were content to put their theories and ideas into (mostly) English prose, and leave it at that. Their big, breezy thoughts made great, but imprecise reading. Contradictions were glossed over. So prolix was Keynes, for example, that he is thought to have said everything at least once.

This will no longer do. Since 1945 or so, practitioners of what was once called “political economy” have become more demanding. They sought to test their grand thoughts against the hard facts of the real world. Incomes, interest rates, and prices of all sorts could be measured. Did they behave as theory supposed? National accounts, the detailed measures of GDP, were just being created, at Keynes's behest. But economic data were, and still are, messy; analysing them even more so. It took decades to develop the tools to detect and measure economic relationships with much certainty.

This year's Nobel prize has gone to two economists who epitomise the rise of statistical techniques: Robert Engle, an American economist at New York University, and Clive Granger, a Briton at the University of California at San Diego. They have crafted some of the most sophisticated tools to analyse economic data. Their contributions, developed during the 1980s, deal especially with “time-series” data: share prices, household consumption, inflation—anything, in fact, that changes over time, and thus poses difficulties for older forms of statistical analysis.

Poets and plumbers

The Nobel committee seems to be highlighting the wide range of ideas and skills that comprise modern economics: a healthy equilibrium, you might say, between poets and plumbers. Last year one of the two winners was a psychologist whose findings contradict many of the assumptions of economic theory. This year the plumbers were back. Only three years have passed since James Heckman and Daniel McFadden were also honoured for sharpening econometrics, the statistical methods with which economic data are analysed.

Mr Engle and Mr Granger have crafted techniques that demand even greater virtuosity at maths, but which are nevertheless crucial in separating wheat from chaff. Mr Engle's work has helped build the foundations for measuring and avoiding myriad types of risks in the modern economy. He has studied the volatility—the severity of swings—of time series ranging from inflation to the prices of securities. Anyone who watches the stockmarkets knows that they undergo periods of wild adolescent swings as well as times of geriatric languor. Until Mr Engle came along, people interested in such things—financial types, mostly, but also regulators—used crude measures of historical volatility, looking back over a year, say, to see what the average of the swings was. They would then use this as a gauge of likely future volatility.

Mr Engle's approach, ARCH (for autoregressive conditional heteroscedasticity, should you insist on knowing) gave researchers the power to test whether and how volatility in one period is related to volatility in earlier times. There often is a link, as casual observation suggests. After several days of stockmarket upheaval, there may be several days of calm. A 3% rise or fall in shares is often heralded by increasing volatility, much as an earthquake is preceded by tremors. Mr Engle's high-powered maths has made market risk easier to forecast. Thus banks and investors who use “value at risk” techniques to analyse their portfolios owe much to Mr Engle. So does the Basel committee which is drawing up new rules for banks' capital requirements.

Mr Granger's research was aimed more at coming to grips with longer-term swings in economic growth, inflation and currencies than with shorter bouts of risk and volatility. Macroeconomic data often share some common features. GDP per head, for example, has tended to grow over time (at least for as long as it has been reliably measured). But the “trend” rate of growth discussed by forecasters—and, yes, by journalists—is never as fixed as they make it seem: it can be influenced by shocks like rising oil prices or wars.

This may obscure deeper relationships hidden in the data, posing tricky problems for statisticians. Using standard statistical tools—derived from things that do not change much over time, such as the distribution of people's heights—can be misleading. An economist using these tools might conclude that a casual relationship existed where none really does, and thus be fooled by a statistical mirage.

Mr Granger devised a clever solution to this, called co-integration. He made use of the notion of economic equilibrium—the idea that variables tend to move towards particular values, and thus in a predictable direction. He found that when two sets of economic data are compared, for example inflation and exchange rates, they can often be treated with standard techniques. In collaboration with Mr Engle, he worked to create tests for economists to ensure that they were getting reliable results when making such comparisons.

Despite these sophisticated techniques, which economists now apply as a matter of course, the analysis of economic data remains messy. “Driving a Mercedes down a cow-track” is how Thomas Mayer, an American academic economist, once described the application of fancy tools to real-world phenomena that are not easy to model, much less to measure.

Even so, the place of econometricians at the centre of economics is now confirmed. Indeed, there now seems to be a dearth of the grand theorists of days past. Specialisation—to use an economists' term—is the order of the day. But then a good plumber is in greater demand than any poet.

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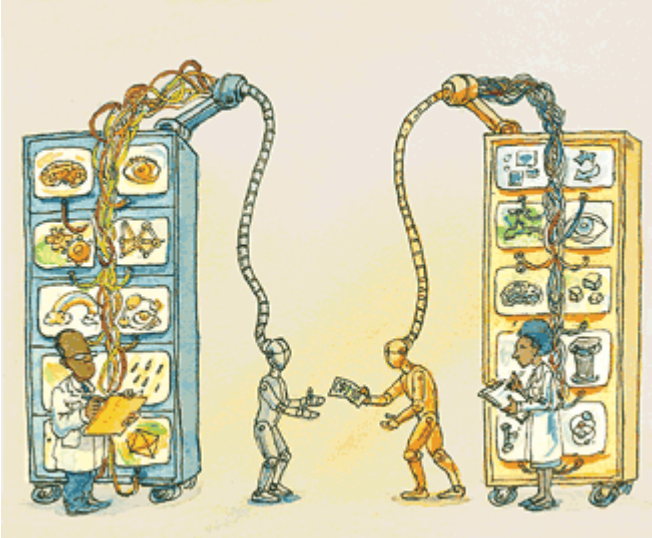
Modelling complexity

Agents of creation

Oct 9th 2003 | OXFORD
From The Economist print edition

Artificial “agents” can model complex systems



THEY certainly cannot be faulted for a lack of ambition. The scientists and engineers who gathered this week in Oxford for the first International Workshop on Complex Agent-Based Dynamic Networks are seeking to explain much of the world's behaviour through the use of “agents”. In this context, an agent is a program that acts in a self-interested manner in its dealings with numerous other agents inside a computer. This arrangement can mimic almost any interactive system: a stockmarket; a habitat; even a business supply-chain. If the constituent parts can be understood, the reasoning goes, some insight into the whole will follow.

The systems that agents have been most successful in modelling so far are financial markets. This is partly because of the obvious interest that people have in understanding such markets, and partly because one of the challenges in setting up an agent-based model is defining clearly what individual agents want. In a financial market that definition is easy: money.

Vince Darley, of Eurobios UK, a consultancy based in London, told the workshop about his efforts to model one such market, the NASDAQ stockmarket based in New York. In 2001, NASDAQ underwent “decimalisation”. It stopped denominating shares in sixteenths of a dollar, and instead divided its dollars into cents. That meant prices could move in smaller increments, which was thought to be a good thing. But NASDAQ's bosses feared there might be unpleasant unintended consequences of the change, so they commissioned Dr Darley and his colleagues to predict what might happen.

The predictions were not perfect: Dr Darley's agents traded larger volumes of shares than real people did. But other forecasts were accurate. In particular, the market became less efficient. This was because so-called parasitic strategies, which try to manipulate the system, work better with small increments.

Sanmay Das, of the Massachusetts Institute of Technology, also uses agents to study financial markets. His studies, though, are designed to illuminate the behaviour of individual market-makers, rather than whole markets.

A market-maker is attempting to find the “true” value of a share—that is, a price that reflects all the commercially significant information relevant to that share. In the model, this value is assigned arbitrarily

and is not “told” to the agents. Instead, they have to work it out. An earlier result had shown that, in a competitive environment, one way to allow agents to compute the true value would be to enforce a “zero-profit” condition on them. This is a restriction on the prices that a market-maker sets for buying and selling shares such that, over time, that market-maker just breaks even.

Actually computing this condition is hard. Instead, Mr Das worked out a way to make a close approximation to the prices that result from the condition. The market-maker can then make money by selling for just slightly more and buying just slightly cheaper than the formula dictates.

When Mr Das simulated a market using this approximation, the results closely matched the statistics of real-world markets. Actual market-makers often behave instinctively, and have difficulty explaining exactly why they set prices as they do. Mr Das's results make the reasons for this unconscious behaviour explicit.

The world as we don't know it

Financial markets are not the only game that agents can play. Neil Johnson, a physicist from Oxford University, told the workshop of his latest research on the so-called minority game. This is a stylised version of a classic problem: a big crowd enters a bar where there are fewer seats than people (or agents). Each individual decides independently whether to stay in the bar or leave. The process is then repeated indefinitely.

Recalling one of Yogi Berra's famous observations, “nobody goes there anymore, it's too crowded,” the agents in such a game adopt a number of different strategies for dealing with the situation. Dr Johnson has dubbed those adhering to Mr Berra's maxim as the “anti-crowd”. By studying what the agents actually do, he is able to build up a mathematical model of their interactions.

Not, you might think, that useful. But he is already working with a group at NASA, America's aeronautics and space agency, which uses like methods to deal with futuristic aeroplane wings. Rather than having just one aileron to control their pitch, these wings have hundreds of little ones. Each is, in effect, an agent. It must decide, based on what it perceives the other ailerons are doing, whether to stay up (ie, stay at the bar) or turn down (leave the bar). The mathematics of the two processes are surprisingly similar.

Less similar, though potentially more surprising, is Dr Johnson's research into crime. He is beginning to study how various organised criminal and paramilitary groups in Colombia interact with one another. Each group is treated as an agent, and they slug it out inside the computer in a game of drugs, money and politics. Whether anything useful will result remains to be seen.

Janet Efstathiou's studies, though, are already proving their worth. Dr Efstathiou, who works in Oxford's Department of Engineering Science, is investigating commercial supply chains in factories and warehouses. Other researchers working in this field discussed how they asked people involved in such supply chains—supermarket buyers, for example—what strategies were followed. They then attempted to create artificial agents that followed similar strategies. The problem with this, as Dr Efstathiou pointed out, is twofold. Not only are people often inaccurate in their beliefs about themselves, but—especially in the business world—they lie.

Instead, she set out to measure what was actually going on in factories and warehouses. She and her team of graduate students spent hours watching and recording which machines were running when. They also looked at where goods were being moved to and from. She then compared her findings about what was really happening with what people claimed was happening on paperwork such as invoices. By checking how often these agreed, she could approximate the mathematical “entropy” of the system—a measure of how disordered it was.

A complicated factory, with many different assembly lines, can still be ordered if everything is proceeding according to plan. Even a simple one, by contrast, would be disordered if managers had no idea of what was happening. Dr Efstathiou's efforts to create a complete agent-based model of all this are still under construction, but the clear-minded attempt to quantify baffling concepts, such as how messy a factory is, seems to be leading her in a direction that might help managers to improve their productivity.

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The Nobel prizes

Magnetic moments

Oct 9th 2003
From The Economist print edition

Laurels for MRI, low-temperature physics and cellular channels

THIS year's lucky winners of a cash prize, a round-trip to Stockholm and a lifetime of envious adulation from their peers have just been announced. The committees that give out the Nobel science prizes have pondered “who, during the preceding year, shall have conferred the greatest benefit on mankind” and come to their conclusions. As usual, the phrase “the preceding year” has been stretched, in some cases to work done decades ago.

The prize for physiology or medicine goes, paradoxically, to a discovery in physics. Magnetic-resonance imaging (MRI) has revolutionised medical practice by doing for soft tissue what X-rays did for bones—permitting doctors to see inside people without cutting them open. The prize-givers at the Karolinska Institute decided that the critical discoveries which led to the development of MRI were made by Paul Lauterbur, of the University of Illinois, and Sir Peter Mansfield, of the University of Nottingham, in England.

MRI works by stimulating certain atomic nuclei (in particular those of hydrogen) with radio waves while at the same time exposing them to a powerful magnetic field. When the stimulation stops, the nuclei relax and give out radio waves of their own. The prize winners' insight was that, if the nuclei in question are in a body, the pattern of radio waves emitted can, using nifty mathematics and lots of computing power, be turned into a picture of what that body's interior looks like. Dr Lauterbur worked out how to make images in principle. Sir Peter worked out how to speed up Dr Lauterbur's method so that it could be used in practice.

The magnets used in MRI machines depend on superconductivity for their power, so it is fitting, if (probably) coincidental, that two of the winners of the physics prize have got their awards for work on superconductivity.

Superconductors are materials that, when cooled sufficiently, conduct electricity without resistance. They come in two types, known with admirable directness as type-I and type-II. Type-I superconductors are simpler to explain, but of limited use since they cannot coexist with a magnetic field. Type-II superconductors, though, do not mind magnetism as much, so those are the ones used in such applications as MRI. Alexei Abrikosov, who now works at the Argonne National Laboratory, in Illinois, and Vitaly Ginzburg of the Lebedev Physical Institute, in Moscow, were responsible for discovering how type-II superconductors work (it is all down to the behaviour of their electrons).

The third physics-prize winner is Anthony Leggett, a colleague of Dr Lauterbur's at the University of Illinois. More coincidence? Again, probably. The physics prize is awarded by Sweden's Royal Academy of Science, which is separate from the Karolinska. Collusion is denied. And Dr Leggett's prize is for work on superfluidity, not superconductivity. But the fields are related. Both require low temperatures and both depend on similar unusual behaviour by the electrons in the materials concerned. Both also result in materials that have, in some sense, no resistance—in the case of a superfluid, this means zero viscosity and frictionless flow.

Like the medicine prize, the chemistry prize was awarded for work that might as easily have come under another heading—in this case medicine itself. The winners chosen by the academy had studied the structure of the protein “channel” molecules that sit in the outer membranes of cells and permit the passage of particular substances. Peter Agre, of Johns Hopkins University, in Baltimore, isolated the channel that transports water. Roderick MacKinnon, of the Rockefeller University, in New York, worked out the structure of the one that carries potassium.

These channels, and their *confrères* that transport sodium, calcium and other simple chemicals, are responsible for keeping a cell's internal chemistry appropriate to its function. Without them, life would be impossible. Obscure? Maybe. Of great benefit to mankind? Undoubtedly.

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Homosexuality

Dyed in the womb

Oct 9th 2003
From The Economist print edition

A lesbian's sexual identity seems to be established before her birth

MEN and women blink differently when startled. That simple and well-established observation has led Qazi Rahman of the University of East London, in England, and his colleagues to evidence supporting the idea that homosexuality is a characteristic which people are born with, rather than one they acquire as they grow up. The team's research, just published in *Behavioral Neuroscience*, shows that lesbians blink like heterosexual men. That, in turn, suggests that the part of their brain that controls this reflex has been masculinised in the womb.

Anyone who is startled by an unexpected noise tends to blink. If, however, the startling noise is preceded by a quieter sound, this blink is not so vigorous as it would otherwise have been. It is this lack of vigour which differs between the sexes. Men blink less vigorously than women when primed in this way.

Given such a clear and simple distinction, testing the responses of homosexuals to noise seemed an obvious experiment to do. So Dr Rahman and his colleagues did it. Their subjects, men and women, gay and straight, were sat down one by one in a dimly lit room. The muscles that cause blinking were wired up with recording electrodes, and the subjects were fitted with headphones through which the sounds (sometimes a single startling noise, and sometimes a combination of soft and loud) were fed.

In the latter case, as compared with the former, straight men had blinks that were 40% less vigorous. In the case of straight women the drop was 13%. Lesbians dropped 33% which, statistically, made them more similar to straight men than straight women. Gay men were also intermediate, although in their case the difference was not statistically significant. Even in this apparently trivial matter, it seems, lesbians have male-like brains. So what is going on?

By default, people are female. Without the influence of testosterone in the womb, a fetus will develop into a girl. The way testosterone acts to turn a fetus male is still poorly understood. It seems likely, though, that different organs respond independently to the hormone, and may do so at different times. Hormonal surges at critical moments could thus cause particular organs in an otherwise female body to become “male”. (A lull in hormone production might have the opposite effect.) If the organ concerned is the brain, the result is more male-like behaviour including, possibly, male-type sexual preferences.

Previous research has provided some evidence for this idea. Lesbians, for instance, are more accurate throwers of objects such as darts than straight women. In this they resemble straight men in a way that has nothing to do with sexual preference. And tissues other than the brain's may be affected, too. On average, lesbians have ring fingers that are longer than their index fingers, a feature that is typical of men but not of heterosexual women. In that context, a difference in the blink of an eye is no surprise at all.

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The shape of the universe

Platonic truths

Oct 9th 2003
From The Economist print edition

Data from an American satellite suggest that the universe is a dodecahedron

THERE are five Platonic solids of perfect symmetry. Three, the tetrahedron, octahedron and icosahedron, have triangular faces. A fourth, the cube, has square faces. The fifth, the dodecahedron, has pentagonal faces. Plato believed that the first four corresponded to the elements of which the Greeks thought the material world was composed: fire, air, water and earth. The dodecahedron, however, corresponded to quintessence, the element of the heavens. As Plato put it, “God used this solid for the whole universe, embroidering figures on it.” And if the arguments of a paper in this week's *Nature* stand up, Plato will have been proved right. For Jean-Pierre Luminet, of the Paris Observatory, and his colleagues believe that the universe is, indeed, a dodecahedron.

They base their argument on data collected by the Wilkinson Microwave Anisotropy Probe (WMAP). This American satellite has been examining the microwave radiation generated shortly after the universe began. The wavelength of this radiation is remarkably pure, but like a musical note it has harmonics associated with it. These harmonics, like those of a note, reflect the shape of the object in which the waves were generated. In the case of the note, that object is a musical instrument. In the case of the microwave background, that object is the universe itself.

The most widely accepted model of the universe suggests that it is both flat and infinite. In this case, flatness does not mean it is two-dimensional, but that the space of which it is composed has no large-scale curves in it. (Small curves induced by gravitational fields, and predicted by the theory of relativity, do exist.) WMAP's data are in close agreement with this model, but that agreement is not perfect. In particular, the second and third harmonics of the microwave radiation are weaker than expected. Dr Luminet's calculations suggest that this weakness can be explained if the universe is finite and dodecahedron-shaped. Of course, things are not quite that simple. Familiar dodecahedrons have an inside and an outside. What Dr Luminet is proposing is actually something called a dodecahedral space, first described by his countryman Jules-Henri Poincaré in the 19th century. Such a space has no boundary, even though it has a finite volume. But it is, quintessentially, a dodecahedron. One up to the Greeks.

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About sponsorship

America's car industry

Shape up or ship out

Oct 9th 2003
From The Economist print edition

Corbis

For the first time in August, Toyota sold more cars in America than Chrysler. Can anything be done?

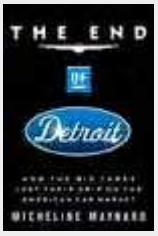
THE last big book about Detroit was “Comeback: The Fall and Rise of the American Automobile Industry” by Paul Ingrassia and Joseph B. White. Published in 1994, it chronicled how Bob Lutz and others masterminded the recovery of Chrysler from its second brush with bankruptcy, and how Ford and General Motors (GM) learned from the Japanese how to make cars of quality more efficiently using “lean production”.

Sure enough, Detroit did look to be cruising along smoothly. Ford, in particular, was making bumper profits by the late 1990s. But the wheelnuts, unnoticed, were loosening and by the end of the decade the wheels had started to come off. In August this year, Toyota sold more cars in America than Chrysler. A fluke, maybe. But the fact is that Detroit is steadily losing ground to its Japanese competitors. The shift also reflects how much the city has declined in importance in the past decade. Chrysler realised it could not survive as an independent company and sold out to Daimler-Benz, makers of Mercedes.

Ford is still reeling, after a crisis that saw its chief executive dumped and the young great-grandson of Henry Ford take the wheel. Ford's profits were $7.2 billion in 1999; by 2001 it was losing $5.4 billion. GM has picked up some momentum, gaining market share, but mainly by discounting. GM started a price war to keep sales going after September 11th 2001, when car showrooms emptied of people. The trouble is, as its chief executive, Rick Wagoner, admitted earlier this year, discounts soon stop being effective sales boosters and suck down profitability.

Micheline Maynard's crisply written book coolly analyses the causes of the latest fall of Detroit. Whereas “Comeback” was replete with colourful stories set in smoke-filled rooms with big personalities and swashbuckling deals, her book digs out the underlying story that was gnawing at Detroit's entrails even as it proclaimed its revival. No fewer than 200 pages are devoted to the plodding professionalism with which the big Japanese, South Korean and European manufacturers planned their assault on the American industry. Inevitably it is a less colourful read than the comeback book, but it provides a more

The End of Detroit: How the Big Three Lost Their Grip on the American Car Market
By Micheline Maynard



Doubleday/Currency; 327 pages; $24.95

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Amazon.co.uk

valuable analysis of what has really been going on.

Many in the American car industry have been slow to appreciate how serious the problem really is. The big three manufacturers were used to hard times; they just hoped to make more money in booms than they lost in busts. But their current problems are different. Car sales are still at historically high levels; it is just that Detroit's share of these sales has slumped. Japanese, South Korean and German models (whether imported or made in the 17 car factories that foreigners have opened in America in the past 20 years) account for half of car sales, and are advancing on Detroit's last redoubt—the gas-guzzling minivans, sport utility vehicles and pick-ups so beloved of suburban cowboys.

In 1960, GM alone had 60% of the American market; today it can count on barely half that and the foreigners' share of the light- vehicle market is already 40%. Ms Maynard pinpoints the difference between the men who run the big three and the leaders of successful foreign car companies. She contrasts the financial background of those at the top of GM and Ford with the car knowledge of Toyota's boss, Fujio Cho, who cut his teeth running one of the company's first American factories. Similarly, the bosses of German car companies, such as Volkswagen, BMW and Mercedes, are all engineers, passionately interested in everything to do with cars.

But there is more to Detroit's weakness. The big three manufacturers have to deal with the powerful United Auto Workers Union, which has won its members great benefits while employers are saddled with pension and health-care costs that top $1,200 per vehicle. Ms Maynard concedes that Detroit is fighting back, with a new emphasis on the quality and attractiveness of the products. But she still sees Toyota becoming the biggest car company in the world, overtaking GM, and probably having no less than 15% of the worldmarket, its stated aim. She is right: Toyota will prevail. Detroit's choice is between shrinking or sinking.

The End of Detroit: How the Big Three Lost Their Grip on the American Car Market.
By Micheline Maynard.
Doubleday/Currency; 327 pages; $24.95

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About sponsorship

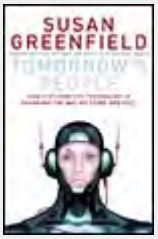
The future

The way we are going

Oct 9th 2003
From The Economist print edition

IN HER preface, Susan Greenfield, a distinguished neuroscientist, admits that she had really wanted to write a novel, a story, seen “through the eyes of a brilliant and beautiful heroine, a female neuroscientist”, about the kind of lives we will be living towards the end of this century. Although she dropped the idea in favour of a work of non-fiction, “Tomorrow's People” is set firmly in the dystopian tradition of Huxley and Orwell. Baroness Greenfield's purpose is to issue a warning: that the coming integration of IT and biotechnology will have such a profound effect on the way we think and live that “we are standing on the brink of a mind makeover more cataclysmic that anything in our history.”

Tomorrow's People: How 21st-Century Technology is Changing the Way We Think and Feel
By Susan Greenfield



Penguin/Allen Lane; 288 pages; £20

Buy it at
Amazon.com
Amazon.co.uk

Baroness Greenfield is acutely aware of the perils of futurology. Visions from the 1950s of a world in which robots performed the domestic chores, meals were taken as pills and we zoomed around in personal helicopters were touchingly wide of the mark. Critically, nobody from that era foresaw the rise and ubiquity of the computer. Thomas Watson, the legendary boss of IBM, once famously predicted that there might turn out to be a world market for just five computers.

In Baroness Greenfield's vision of the future there is no dividing line between the real and the virtual, and most of our experiences are shaped either by a souped-up version of the internet or by smart drugs. We will rarely have to leave our homes, which will become an extension of our minds and bodies. Entertainment will be on tap to match our moods, while our physical environment, from the view through our windows to the shape of our rooms and the furniture inside them, will have the protean ability to adapt itself to our desires and needs. There will be no cancer or baldness or obesity. Nano-machines inside our bodies will change our appearance at will. Our bodily functions will be monitored and any incipient malfunctions dealt with by clothes that both dispense drugs and have the happy knack of cleaning themselves.

Relationships with other human beings will increasingly become too troublesome and unrewarding compared with the more immediate satisfactions to be had from the ever-present networked screens. We will be able to have sex virtually with anyone, while reproduction will be possible at any stage of our lives and regardless of our sexuality. Knowledge of any skills other than those of the technological elite will become a redundant concept because all the information we will ever need will be instantly available to us all, and because intelligent machines will be able to undertake almost any task better and more quickly that we can ourselves. Reading and writing will be redundant. As for privacy—what was that?

What makes this at least semi-believable is that the technology probably will soon be available to render much of this possible. Moore's Law alone, which decrees that computer-processing power will double every 18 months and has at least another ten years to run, will soon allow computers to do things that are almost unimaginable. After that should come quantum computing—an advance comparable to the replacement of the vacuum tube by the transistor. As professor of pharmacology at Oxford University, Baroness Greenfield is well-placed to understand the impact of the next generation of mind-altering drugs, while the applications for nanotechnologies seem almost limitless.

The author is, thank goodness, horrified by the vision of the future she depicts: “The private ego is the most precious thing we have and it is far more vulnerable than ever before.” That ego, our individualism, is not, she argues, the automatic corollary of having been born human, but instead depends on the availability of an appropriate environment—an environment which, for the first time, we can no longer take for granted. What frightens her is the possibility that we will become so immobilised by dreams and shadows, so free of pain, mentally standardised by the cyber-world that is our principal habitat and

rendered oblivious by chemicals, that we will have lost the ability to choose. Scary stuff indeed. That said, she surely makes insufficient allowance for the “yuck” factor. Human beings are a stubborn lot. If we don't like something, we're quite good at avoiding doing it.

Tomorrow's People: How 21st-Century Technology is Changing the Way We Think and Feel.
By Susan Greenfield.
Penguin/Allen Lane; 288 pages; £20

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Rugby

Rugger huggers

Oct 9th 2003
From The Economist print edition

Warm memories of the scrum

FIFTEEN years ago, the idea that England could possibly raise a team of expertly trained professionals with a chance of winning the rugby World Cup in Australia—a real possibility this year—would have amused the rugby fraternity no end.

Amused, because rugby used to be something else. It was rugger, an amateur game played by muddy schoolboys and beery men for pleasure and not for commercial opportunism. This is a distinction that anyone who has followed the game will understand. Whereas rugby league offered working-class northern boys six shillings to miss work and play in a club match, English rugby union, or rugger, was traditionally a public-school gymkhana—a social as much as a sporting event.

Muddied Oafs: The Last Days of Rugger
By Richard Beard

Yellow Jersey Press; 274 pages; £14.99

Buy it at Amazon.co.uk

Richard Beard tackles these preconceptions head on, making unfashionable rugger the hero of the piece against the backdrop of rugby's new professional era. Now in his mid-30s, the author, a “nomadic rugbyman”, packs his rugby boots and revisits the playing fields of his youth—Radley College, Cambridge University, the Scottish Highlands, Paris, Geneva and provincial England—to reconcile the contradictions at the heart of the game. Mr Beard is an elegant novelist as well as a stylish England rugby prospect, at least in his own head. He idealises the athlete-poet, admittedly a rare breed in rugby, as he observes in elegant rugger-speak: “Sensitive writer types often object to a good shoeing at the base of a debateable ruck.”

Yet he echoes the game's Victorian founders by insisting that the man-making and moral virtues of rugby have enriched his life, and, more surprisingly, protected him against professional conformity. “At the amateur level, rugby sets the players at odds with society. Doing anything not for money is odd, but we're doing something seriously and not for money, with the risk of getting hurt, and not for money.”

His is an enviable journey of camaraderie and sporting dreams that will resonate with all team players. Rugby, it transpires, is not that oafish at all. The French player of *le rugby* is a noble, free spirit, albeit prone to violence. And the sport is winning new disciples from Bilbao to Tbilisi, as the rival code, rugby league, shrinks back into its heartlands. Mr Beard cannot help but proselytise, particularly in his opinion of rugby's superiority over soccer. Does rugby really form “reliable men”, more reliable than soccer? Difficult to say. What is certain is that this funny, trenchant book settles many a score.

Muddied Oafs: The Last Days of Rugger.
By Richard Beard.
Yellow Jersey Press; 274 pages; £14.99

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Science and the Nazis

Bullying by numbers

Oct 9th 2003
From The Economist print edition

JOHN CORNWELL's account of the dilemmas faced by scientists and mathematicians after the rise of Hitler begins before the first world war, when German science was at its peak. German speakers had won more than half of the Nobel prizes in science, while extensive collaboration with industry led to profitable development of soaps, fertilisers, pharmaceuticals, dyes and other products. The war had opened a period of difficulty for the scientific community, but in the late 1920s German science began to recover its prestige. This was destroyed by the rise of National Socialism.

After Hitler came to power in 1933, Jewish scientists were dismissed en masse from their jobs. Hitler cared little for the damage this would cause German science. “If science cannot do without Jews, then we will have to do without science for a few years,” he told Max Planck, a physicist. Indeed, half of Germany's theoretical physicists lost their jobs, to the immense benefit of Britain and America, which gained a generation of talented minds.

Some scientists supported the Nazis or used the dismissals for personal advantage. Empty positions were filled by junior colleagues, usually without protest or delay. But could scientists opposed to Nazi policies retain their integrity and continue to work in Germany? Many scientists chose to stay, and hoped to preserve German science for better times. Among them was Max von Laue, another physicist, who had spoken bravely on Einstein's behalf in the early 1930s (and who is said to have developed a habit of carrying large parcels under each arm, to avoid having to give the Nazi salute).

Other cases are more debatable. Mr Cornwell devotes several chapters to Werner Heisenberg, whose wartime conversations with Niels Bohr have been famously dramatised in Michael Frayn's recent play, “Copenhagen”. Despite ample opportunity to leave, Heisenberg chose to remain in Germany and ran the German atomic-bomb programme. He made a poor director, and some have suggested that he in effect sabotaged the programme. Mr Cornwell sees no evidence for this, arguing that Heisenberg was neither a hero nora villain, but was instead “morally and politically obtuse”.

Sanford Segal's book looks in depth at the fate of German mathematics under Hitler. Mathematicians, of course, were also faced with the wave of expulsions of Jews from the profession. For those who remained, Nazism quickly impinged on their lives. Mathematicians were subject to repeated political evaluations. University employees had to swear oaths of loyalty to Hitler and greet their colleagues with the Nazi salute. Foreign contacts and travel were strictly limited, and research stagnated.

Some mathematicians, such as Hermann Weyl, chose to leave, while many remained and kept a low profile. However, a few collaborated with enthusiasm. A particularly egregious example was Ludwig Bieberbach, a senior professor in Berlin and a leading mathematician of the period. Bieberbach was an enthusiastic proponent of Nazi ideology, publicly advancing a theory of racial and national differences in mathematical style. His theory divided mathematicians into two types: Jewish or French mathematicians (the “S-type”) were pure theorists who imposed their ideas upon the world, while true German mathematicians (the “I-type”) supposedly understood the world as it really was.

Hitler's Scientists: Science, War, and the Devil's Pact
By John Cornwell

Viking; 535 pages; $29.95 and £20

Buy it at
Amazon.com
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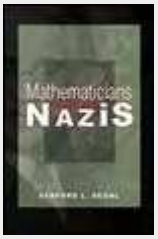
Mathematicians Under the Nazis
By Sanford L. Segal



Princeton University Press; 530 pages; $79.50 and £52.95

Buy it at
Amazon.com
Amazon.co.uk

Mr Segal's account of this episode is one of the most interesting parts of the book. While the maths may at times prove too technical for the lay reader, the strength of the book lies in its many individual stories and case histories. Mr Cornwell's work is more wide-ranging and accessible, and evokes the moral dilemmas of the period very effectively. Both books offer disturbing and important accounts of the life of science and scientists under the Nazis.

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New British fiction

Layered words

Oct 9th 2003
From The Economist print edition

REBECCA, the narrator of Helen Dunmore's excellent new novel, is an orphan, abandoned by her mother and left in a shoebox outside an Italian restaurant. As a young adult she shares a flat with Joe, a brilliant young historian, but falls in love with a friend of his, a neonatologist called Adam. Rebecca and Adam marry and have a baby girl, Ruby. But when Ruby is four, she is killed in an accident. Rebecca is inconsolable. The marriage falls apart and she separates from Adam. After months of despair, she slowly gets back on her feet, taking a job as PA to a luxury-hotels tycoon.

Events are not related in order. Ruby's death is signalled in the first few pages but is not described until more than halfway through the novel. Ms Dunmore's toing and froing between past and present is artfully done and greatly enriches the central story of the death of a child and a parent's grief. There are lovely passages about Adam's hospital work with other people's children, for instance, and about Rebecca's work for Mr Damiano, the hotelier, which chime in unexpected ways with the novel's main themes of love and loss. Ms Dunmore's beautifully measured, unostentatious prose conveys terrible shudders of feeling. She is a marvellous writer and “Mourning Ruby”, despite its occasional longueurs, is a real gem.

Mourning Ruby.
By Helen Dunmore.
Penguin/Viking; 310 pages; £16.99. To be published in America by Putnam next March

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Literary biography

The forgotten

Oct 9th 2003
From The Economist print edition

JOHN CLARE, peasant poet of rural Northamptonshire, was the son of an agricultural labourer. Aside from his poetry, which was a life-long obsession, he was in turn a thresher, bird-scarer, plough boy, pot scourer and gardener. Clare the poet was discovered in 1819 by a local bookseller. He was 26. Later, Clare declined into obscurity and spent his last 30 years in an asylum. Such are the bald, sad facts of the life.

John Clare: A Biography
By Jonathan Bate

Farrar, Straus and Giroux; 672 pages; $40. Picador; £25

Buy it at
Amazon.com
Amazon.co.uk

Clare was not an uneducated man. He read voraciously, especially the English poets, but he was in love with his own Northamptonshire dialect and he despised the tyranny of conventional grammar. His spelling was wildly inconsistent; like W.B. Yeats, who was also an atrocious speller, he heard words in different ways at different times. Being desperately poor, paper was always scarce—as was ink. The consequence of all this was that Clare's manuscripts, so crowded with words, were notoriously difficult to read and decipher. Clare poured forth a torrent of poems. Editing them was a labour of love and many remained unpublished until late in the 20th century. Difficult decisions had to be made, one of which was whether he should be regularised to suit a metropolitan audience. Without editorial work, Clare would always remain a semi-literate, child-like primitive; with the wrong kind of editorial interference his virtues could easily fail to be recognised.

Given the drawbacks, then, what were his virtues? At its best, Clare's poetry deals with the minute particulars of rural life. He idealised his native village, Helpston, its local customs, bird life, brakes and spinneys. He wrote matter-of-factly, as he spoke, about very particular things: posts, stones, flowers. The poems are simple, precise and beautifully attentive. The dialect words, too, are stunningly rich and evocative: “pooties” (snail shells), “crizzle” (to freeze), “cowslaps” (cowslips), “whirl puffs” (a sudden gust of wind driving the dust into an eddy). The mixture of emotional heat and cool precision is rare among poets.

Clare's first book sold well. He was received as an authentic, untutored rural genius, which was true in part, and educated audiences were delighted by such an engaging idea—at least, at first. As his poetry matured, however, his audience declined; probably, the idea of a peasant poet can engage the attention of fickle townies for just so long, and no more.

Clare's last years were tragic. When asked why, Fenwick Skrimshire, the grisly named doctor who admitted him to the Northampton General Lunatic Asylum in 1841, attributed the poet's decline to: “years of addiction to poetical prosing”. In his last years, Clare believed himself to be Sir Walter Scott, Lord Byron and other poets who had enjoyed enduring fame during his lifetime. When asked what inspired his poetry, Clare replied that it “came to him in the fields, whilst walking”, that he had “kicked it out of the clods”. There it had been, his for the miraculous taking.

Neglected for much of the 19th century, Clare was rehabilitated by a succession of fellow poets and poet/editors, including Edmund Blunden, Edward Thomas and Geoffrey Grigson, all of whom recognised the virtues of such a close and passionate love for the particular. John Ashbery wrote this of him: “Clare is someone I turn to when I really need to be reminded of what poetry is.” And in Jonathan Bate, John Clare has found a scrupulous and sensitive biographer.

John Clare: A Biography.
By Jonathan Bate.
Farrar, Straus and Giroux; 672 pages; $40. Picador; £25

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About sponsorship

Soviet Realism

Fields of dreams

Oct 9th 2003 | FRANKFURT
From The Economist print edition

Soviet Realism, it ain't all bad

This way, the future

IN THE 1930s there was a picture-generating machine producing a standardised kind of art called Soviet Realism. The machine's job was to tell the masses about the future. Things are getting better and better went the message. If you show a little patience, they'll get better still. Were the truculent masses to disagree with that message, they were changed—the masses, that is, not the pictures. Josef Stalin operated the machine. When he shook his head disapprovingly, as he often did, the picture disappeared—along with the painter.

Though crude, that summary is largely true. But according to a new show of paintings, posters and film from the Stalin years, curated by Boris Groys, that does not mean that all Soviet Realist art is necessarily dreadful. The show's most affecting room is the first. A sweep of best, Kremlin-weave red carpet leads you up to a daunting display of some of the great (meaning large) icons of those years. Take Vasily Yefanov's "An Unforgettable Encounter" (1936-37), for example, on loan from the Tretyakov gallery in Moscow. Here Stalin leans over to clasp the hand of the wife of an engineer. The room is thronged with people—wives, engineers and members of the government. Even Lenin's widow is present. The mood is one of ecstatic optimism. Everyone is clapping. Everyone is smiling. There are flowers everywhere. Yes, the future is already in bloom—here, at least.

Elsewhere in this room Uncle Joe variously meets Chairman Mao, pays homage at the coffin of Andrei Zhdanov and harangues the party faithful. Each image is an exercise in Baroque extravagance mingled with 19th-century Russian academicism. It is a 20th-century form of Baroque that deals with the ecstatic moment; the sacred encounter involves not Jesus Christ but Uncle Joe.

Elsewhere in the show there are fascinating links with other movements in 20th- century painting, works that hover at the edge of the kind of experimentation which would have been officially proscribed: Isaac Brodsky's monumental depiction of "The Second Congress of the Comintern" (1924) in the Uritsky Palace, which consists of hundreds of heads of national representatives, looks, for example, like a huge, surrealistic photo-collage.

The atmosphere of a hushed, carpeted room full of paintings superficially resembles a gallery in a national museum—but this is a deception. Images like these were created not to be revered as paintings, but to be mass-produced and disseminated, throwing light into every ideologically darkened corner of the Russian empire. It was art for a mass culture, but, unlike the mass cultural products of the West, it was entirely non-commercial. It existed without a market. As Mr Groys puts it: "Soviet mass culture was not interested in the taste of the masses. It was only interested in the future masses." If the public didn't like it—and they generally didn't—then tough.

"Dream Factory Communism" is at the Schirn Kunsthalle, Frankfurt until January 4th 2004

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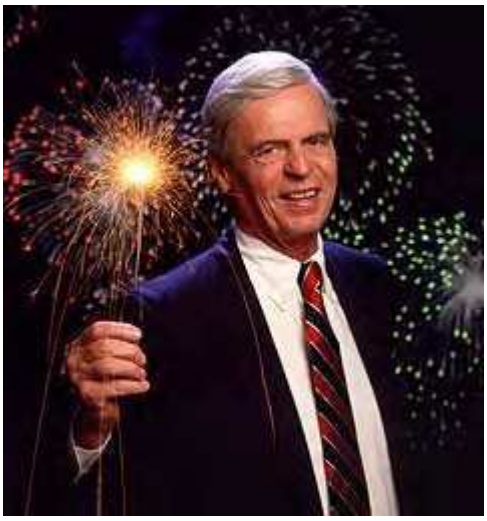
George Plimpton

Oct 9th 2003
From The Economist print edition

George Ames Plimpton, writer and madcap, died on September 25th, aged 76

Getty News



PERHAPS Ernest Hemingway started it. In the 1920s he was a hungry young writer in Paris, inventing a new way of putting words together that was to make him the world's best-known novelist. “Happiness”, Hemingway wrote much later, “is a moveable feast”, and “A Moveable Feast” was the title he gave to a nostalgic memoir of his life in Paris at that time. In the 1950s a new generation of young Americans felt the allure of Paris. Like Hemingway, they had been in a war. They were not especially hungry. Some were rich. All had dollars in their pockets. America had treated them generously for their wartime services. Still, “they seemed endlessly delighted in posing as paupers and dodging the bill collectors,” wrote Gay Talese in an essay called “Looking for Hemingway”. They lived “in happy squalor on the Left Bank for two or three years amid the whores, jazz musicians and pederast poets.” In the summer they drove down to Pamplona to run from the bulls, as Hemingway had done. In the winter, like him, they skied in the Alps.

George Plimpton was probably the most interesting of the young Americans. He was working on his first novel and one of the walks that he liked to take in Paris was in Montparnasse, along the streets that Jake Barnes takes after leaving Lady Brett in Hemingway's “The Sun Also Rises”. Then he would go into a bar and have a drink, as Hemingway would have done. Some friends of Mr Plimpton persuaded him to take over as publisher and editor of a little magazine called the *Paris Review*. The *Review* was one of many literary magazines of the time that would be started, with great hopes, and die after a few issues when the printer could not be paid. The *Review* survived. It was also extraordinarily good. It published much early work by gifted writers, among them Philip Roth and Italo Calvino. Its interviews with established writers, among them, naturally, Hemingway, remain important pieces of biography. Mr Plimpton was to go on to do many amazing things, but keeping the *Review* going and maintaining its quality was his best achievement. He put the 50th anniversary edition to bed the night before he died.

With the Kennedys

George Plimpton was born into what is regarded as aristocracy in the United States. His father was a wealthy lawyer who later became a diplomat. At Harvard he became chums with many of the people who were part of America's privileged circle of influence. He was close to the Kennedys and was one of the team that helped to get John Kennedy elected president. After Kennedy was murdered he joined Kennedy's brother Bobby in his bid in 1968 to become president and was with him when he too was shot dead.

Mr Plimpton was not by nature a name dropper. Being with the Kennedys, playing tennis with the elder George Bush, travelling with Bill Clinton, knowing movie stars: what was exceptional about that? Doesn't everybody? He wanted to be known as a writer, and wrote a couple of dozen books, more than his hero Hemingway did. But although in 2002 the American Academy of Arts and Letters graciously named Mr Plimpton as a “central figure in American letters”, it is difficult to think of a title of his that will endure. Possibly “Paper Lion”. It is a funny account of his disastrous experience playing football with the Detroit Lions. He was applauded as he hobbled from the field “in appreciation of the lunacy of my participation”.

There were other lunatic moments in Mr Plimpton's experiences in what he called participation. In tennis, Pancho Gonzalez beat him easily. In golf, he lost badly to Arnold Palmer. He climbed from the boxing ring his face blooded by Archie Moore; never mind, hadn't Hemingway once been floored by Morley

Callaghan, a Canadian writer then in Paris?

It wasn't a bad journalistic idea: the outsider taking on the professional, and showing that being a pro takes more skill than is often realised. Other writers have done the same. But the public, uninterested that Mr Plimpton might have a serious motive for his jaunts, took the view that he was simply a moneyed idiot looking for ways to pass the time. He persuaded Leonard Bernstein to let him join an orchestra he was conducting, and was allowed to help out with the percussion. But even playing the triangle is a skill. He missed his cue in a Mahler symphony. Determined not to miss out next time, he prepared to strike the gong softly in a Tchaikovsky piece. But, in a state of nerves, he bashed it with all his strength, bringing the performance abruptly to a premature end. Mr Plimpton's oeuvre includes a number of movies, but his parts tended to be brief. He was an Arab in “Lawrence of Arabia” and was beaten to the draw by John Wayne in a western.

He was much liked by those who knew him well. “Friends were almost always happy to see him because you knew he was bound to improve your mood,” said Norman Mailer. “Few could tell a story with equal humour.” Cheered-up friends seemed always ready to chip in to keep the *Paris Review* going. George Plimpton said that some people called him a dilettante who was “having too much fun”. But there was nothing “inherently wrong in having fun”. And he gave a lot of people fun too.

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Overview

Oct 9th 2003
From The Economist print edition

The **dollar** fell further against other major currencies on growing concerns about America's huge current-account deficit and a belief that the Bush administration has abandoned its strong dollar policy. The dollar fell to a three-year low of ¥109, and a seven-year low against the Canadian dollar. Following comments from Wim Duisenberg, the outgoing president of the European Central Bank, that a fall in the dollar was “unavoidable”, the euro rose above $1.18, within a whisker of its record high of $1.19 recorded in June.

Investors reckon that a weaker dollar is good for American corporate profits. The **Dow Jones industrial average** rose by 1.7% over the week. More surprising, stockmarkets in Japan and Europe also notched up gains.

Non-farm payrolls in **America** rose by 57,000 in September, the first increase since January, but manufacturing employment continued to decline. The unemployment rate held steady at 6.1% of the labour force. The 12-month rate of growth in average hourly earnings slowed to 2.7%, down from a rate of 3.5% early this year. America's ISM index of the non–manufacturing sector unexpectedly fell in September. However, the consumer-spending boom continues apace, with retail sales up by 6.5% in the year to August.

Britain's industrial production fell by 0.9% in August; output of motor vehicles dropped by 2.9%. In the **Netherlands**, industrial production declined by 1% in the year to August.

Swiss unemployment rose to 3.7% of the labour force in September, its highest rate for five years. Industrial production fell by 2.8% in the year to the second quarter.

Metal prices hit fresh highs after heavy buying by investment funds. Copper rose to $1,871.50 a tonne, its highest price since December 2000. Nickel rose to $10,775, its highest since September 1990. Speculative buying drove **platinum** prices to a 23-year high of $730 an ounce. But gold prices dipped below $370 an ounce during the week—down from more than $390 in late September—before recovering slightly.

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Output, demand and jobs

Oct 9th 2003
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2003	2004	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.0	Q2	+ 0.5	+ 2.8	+ 3.6	+ 1.3	Q2	+ 3.6	Q2	5.8	Sep	6.2
Austria	+ 1.0	Q1	+ 0.7	+ 0.6	+ 1.7	+ 6.7	Jan	– 0.3	Jul	4.5	Aug	4.3
Belgium	+ 0.8	Q2	– 0.4	+ 0.8	+ 1.8	+ 1.6	Jul	+ 0.9	Jul	13.2	Sep†	12.0
Britain	+ 2.0	Q2	+ 2.4	+ 1.7	+ 2.5	– 0.8	Aug	+ 3.8	Aug	5.1	Jul††	5.2
Canada	+ 1.6	Q2	– 0.3	+ 2.0	+ 3.0	+ 1.5	Jul	+ 3.6	Jul	8.0	Aug	7.5
Denmark	– 1.0	Q2	– 2.2	+ 1.0	+ 2.1	+ 1.0	Aug	+ 2.2	Jun	6.1	Aug	5.1
France	– 0.3	Q2	– 1.3	+ 0.4	+ 1.8	– 1.1	Jul	– 2.2	May	9.6	Aug	9.1
Germany	– 0.2	Q2	– 0.2	nil	+ 1.5	+ 1.4	Jul	– 4.9	Aug‡	10.5	Sep§	9.8
Italy	+ 0.3	Q2	– 0.3	+ 0.4	+ 1.6	+ 0.4	Jul	– 0.4	Jul	8.7	Jul	9.0
Japan	+ 3.0	Q2	+ 3.9	+ 2.5	+ 1.9	– 1.2	Aug	– 2.6	Jul	5.1	Aug	5.5
Netherlands	– 1.2	Q2	– 2.4	– 0.5	+ 1.3	– 1.0	Aug	– 7.7	Jun	5.3	Aug**	4.2
Spain	+ 2.3	Q2	+ 2.7	+ 2.1	+ 2.8	– 1.7	Aug	+ 3.6	Jul	11.4	Aug	11.4
Sweden	+ 1.1	Q2	+ 1.1	+ 1.5	+ 2.3	+ 2.5	Jul	+ 6.4	Aug	5.4	Aug†	4.1
Switzerland	– 1.0	Q2	– 1.2	– 0.4	+ 1.3	– 2.8	Q2	+ 1.5	Jul	3.7	Sep†	2.6
United States	+ 2.5	Q2	+ 3.3	+ 2.6	+ 3.7	– 1.0	Aug	+ 6.5	Aug	6.1	Sep	5.7
Euro area	+ 0.2	Q2	– 0.3	+ 0.5	+ 1.8	– 0.3	Jul	nil	Jul	8.8	Aug	8.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 0.8	Q2	+ 2.4	na	na	+ 1.9	Aug	+ 2.7	Jun	7.7	Aug†	8.1
Greece	+ 4.5	Q2	+ 0.4	na	na	+ 2.1	Jul	na		na		na
Iceland	+ 2.7	Q2	na	na	na	– 0.3	2002	na		2.9	Aug†	2.2
Ireland	+ 0.5	Q1	na	na	na	+ 6.9	Jul	+ 2.1	Jul	4.5	Aug	4.3
Luxembourg	+ 1.1	2002	na	na	na	– 3.6	Jun	– 0.1	May	3.6	Aug	2.9
New Zealand	+ 2.0	Q2	– 0.5	na	na	+ 2.5	Q2	+ 5.1	Q2	4.7	Q2	5.2
Norway	– 2.0	Q2	– 0.6	na	na	– 4.7	Aug	+ 6.5	Aug	4.7	Q2	4.0
Portugal	– 2.3	Q2	+ 0.5	na	na	+ 2.1	Aug	– 1.4	Aug	6.2	Q2†	4.5

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††May-Jul; claimant count rate 3.1% in Aug. §EU harmonised rate 9.4% in Aug. **Jun-Aug.

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Prices and wages

Oct 9th 2003
From The Economist print edition

% change on year ago

	Consumer prices latest		Consumer prices year ago	The Economist poll consumer prices forecast 2003	The Economist poll consumer prices forecast 2004	Producer prices latest		Producer prices year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 2.7	Q2	+ 2.8	+ 2.8	+ 2.4	+ 0.2	Q2	– 1.1	+ 5.5	Q2	+ 3.7
Austria	+ 1.1	Aug	+ 1.9	+ 1.3	+ 1.2	+ 1.3	Sep	– 0.1	+ 2.3	Aug	+ 2.3
Belgium	+ 1.8	Sep	+ 1.3	+ 1.4	+ 1.3	– 1.4	Aug	+ 0.8	+ 1.9	Q3	+ 2.1
Britain	+ 2.9	Aug	+ 1.4	+ 2.7	+ 2.3	+ 1.6	Aug	+ 0.4	+ 3.4	Jul	+ 3.9
Canada	+ 2.0	Aug	+ 2.6	+ 2.7	+ 1.9	– 2.0	Aug	+ 0.6	+ 4.6	Jul	+ 2.9
Denmark	+ 1.7	Aug	+ 2.3	+ 2.2	+ 1.8	– 0.3	Aug	– 0.4	+ 3.8	Q2	+ 3.7
France	+ 1.9	Aug	+ 1.8	+ 2.0	+ 1.4	+ 0.5	Aug	– 0.1	+ 2.7	Q2	+ 3.9
Germany	+ 1.1	Sep	+ 1.1	+ 1.0	+ 0.7	+ 0.8	Aug	– 0.5	+ 2.2	Jul	+ 2.3
Italy	+ 2.8	Sep	+ 2.6	+ 2.7	+ 2.0	+ 1.3	Aug	+ 0.6	+ 2.6	Aug	+ 2.3
Japan	– 0.3	Aug	– 0.9	– 0.3	– 0.2	– 0.6	Aug	– 2.0	– 0.2	Aug	– 2.7
Netherlands	+ 2.1	Aug	+ 3.3	+ 2.3	+ 1.7	+ 2.6	Aug	+ 0.4	+ 2.6	Sep	+ 3.4
Spain	+ 3.0	Aug	+ 3.6	+ 3.0	+ 2.5	+ 1.1	Aug	+ 0.7	+ 4.2	Q2	+ 4.0
Sweden	+ 1.7	Aug	+ 2.0	+ 2.2	+ 1.7	– 1.7	Aug	– 0.3	+ 3.2	Jul	+ 2.7
Switzerland	+ 0.5	Sep	+ 0.5	+ 0.6	+ 0.6	– 0.3	Aug	– 1.4	+ 1.8	2002	+ 2.5
United States	+ 2.2	Aug	+ 1.8	+ 2.2	+ 1.4	+ 3.4	Aug	– 1.5	+ 2.7	Sep	+ 2.9
Euro area	+ 2.1	Sep	+ 2.1	+ 2.0	+ 1.5	+ 1.4	Aug	– 0.1	+ 3.0	Q1	+ 3.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.6	Aug	+ 1.4	na	na	– 0.1	Aug	– 1.8	+ 4.3	Q2	+ 3.9
Greece	+ 3.3	Aug	+ 3.5	na	na	+ 2.2	Aug	+ 2.1	na		na
Iceland	+ 2.2	Sep	+ 3.1	na	na	+ 3.6	Sep	+ 6.1	+ 5.7	Aug	+ 6.0
Ireland	+ 3.2	Aug	+ 4.5	na	na	– 7.8	Aug	– 2.2	+ 8.7	Q2	+ 3.5
Luxembourg	+ 2.1	Sep	+ 2.0	na	na	+ 0.6	Jul	– 0.9	nil	Jun	– 0.6
New Zealand	+ 1.5	Q2	+ 2.8	na	na	– 2.0	Q2	+ 1.5	+ 2.3	Q2	+ 2.1
Norway	+ 2.1	Aug	+ 1.4	na	na	+ 6.1	Aug	– 8.6	+ 5.4	Q2	+ 4.9
Portugal	+ 2.8	Aug	+ 3.7	na	na	+ 0.1	Aug	+ 0.2	– 1.7	Aug	– 0.6

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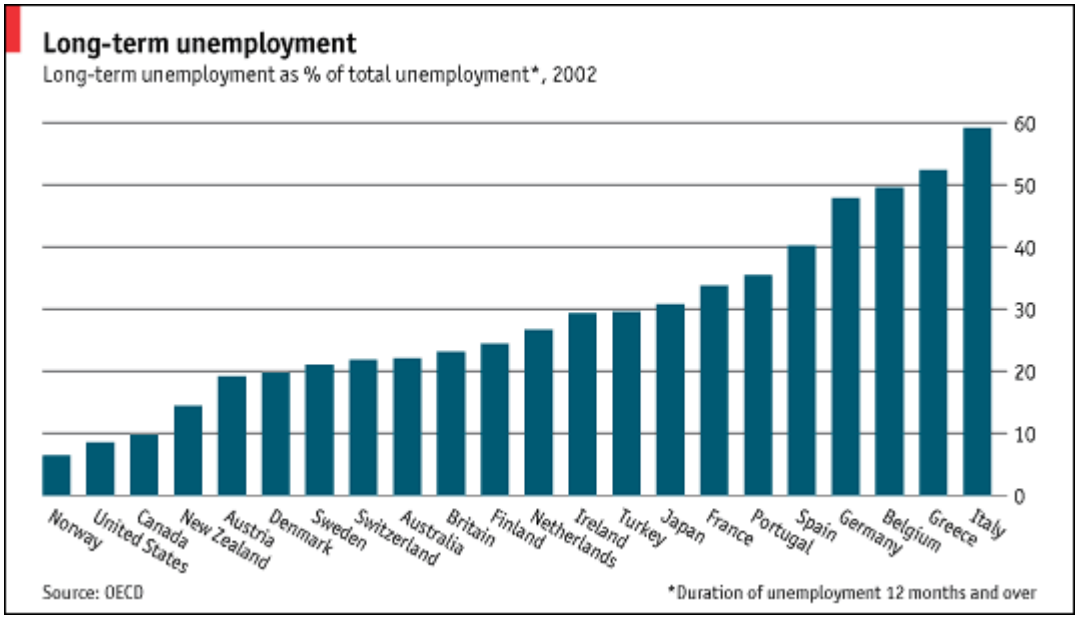
Long-term unemployment

Oct 9th 2003
From The Economist print edition



Relatively few Americans who are unemployed stay jobless for long. But in many European countries, a high proportion of the unemployed remain out of work for a year or more. The contrast is one example of how America's labour market functions better. The longer that people are out of work, the less effectively they compete with those in employment to keep their wages in check.

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Money and interest rates

Oct 9th 2003
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Oct 8th 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 7.4	+12.2	Aug	4.95	4.89	5.08	5.58	5.57	6.27
Britain	+ 7.9	+ 6.6	Aug	3.84	3.91	4.23	4.74	4.41	5.75
Canada	+ 9.3	+ 5.9	Aug	2.61	2.81	3.03	4.75	4.95	6.19
Denmark	+ 7.3	+ 8.9	Aug	2.13	3.45	2.77	4.34	4.47	5.53
Japan	+ 5.5	+ 2.0	Aug	0.02	0.02	0.10	1.33	1.14	1.46
Sweden	+ 3.8	+ 5.5	Aug	2.70	4.03	3.13	4.70	4.82	3.79
Switzerland	+24.8	+ 9.9	Aug	0.24	0.76	-0.64	2.62	2.52	2.88
United States	+ 8.6	+ 8.0	Aug	1.06	1.68	1.62	4.24	3.58	5.93
Euro area†	+11.8	+ 8.2	Aug	2.13	3.23	2.54	4.16	4.25	4.19

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.17%, Japan No.254 1.33%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 3.5%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Oct 9th 2003
From The Economist print edition

1995=100

	Sep 30th	Oct 7th*	% change on one month	% change on one year
Dollar index				
All items	81.7	81.5	+ 0.6	+ 9.8
Food	82.1	81.0	– 0.1	+ 2.1
Industrials				
All	81.1	82.3	+ 1.6	+22.2
Nfa†	86.2	86.4	+ 0.1	+22.0
Metals	76.8	78.8	+ 3.2	+22.3
Sterling index				
All items	77.5	77.1	– 4.1	+ 2.5
Euro index				
All items	92.2	91.1	– 4.4	– 8.7
Yen index				
All items	97.1	95.1	– 5.2	– 3.2
Gold				
$ per oz	385.25	376.45	– 1.2	+17.8
West Texas Intermediate				
$ per barrel	29.13	30.39	+ 4.3	+ 3.2

* Provisional. † Non-food agriculturals.

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Stockmarkets

Oct 9th 2003
From The Economist print edition

Market indices

	Oct 8th	2003 high	2003 low	% change on one week	% change on record high	% change on Dec 31st 2002 in local currency	% change on Dec 31st 2002 in $ terms
Australia (All Ordinaries)	3,247.8	3,247.8	2,673.3	+ 2.6	– 5.6	+ 9.2	+34.0
Austria (ATX)	1,373.9	1,382.4	1,120.2	+ 2.0	–20.9	+19.5	+34.5
Belgium (Bel 20)	2,100.5	2,122.8	1,426.6	+ 0.9	–43.0	+ 3.7	+16.8
Britain (FTSE 100)	4,268.6	4,314.7	3,287.0	+ 2.4	–38.4	+ 8.3	+11.8
Canada (Toronto Composite)	7,569.3	7,636.0	6,228.6	+ 0.8	–33.5	+14.4	+35.9
Denmark (KBX)	212.0	217.5	145.0	+ 2.4	–29.8	+27.5	+43.5
France (SBF 250)	2,223.2	2,318.0	1,630.1	+ 2.2	–49.4	+ 8.3	+21.9
(CAC 40)	3,248.6	3,422.8	2,403.0	+ 1.8	–53.1	+ 6.0	+19.4
Germany (DAX)	3,395.3	3,668.7	2,203.0	+ 2.0	–57.9	+17.4	+32.1
Italy (BCI)	1,186.0	1,218.8	959.4	+ 2.0	–45.7	+ 8.6	+22.3
Japan (Nikkei 225)	10,542.2	11,033.3	7,607.9	+ 1.7	–72.9	+22.9	+33.1
(Topix)	1,054.8	1,075.7	770.6	+ 2.4	–63.4	+25.1	+35.5
Netherlands (AEX)	317.1	342.2	218.4	+ 1.8	–54.8	– 1.7	+10.6
Spain (Madrid SE)	734.5	768.6	576.8	+ 2.5	–35.9	+15.9	+30.4
Sweden (Affarsvarlden Gen)	174.3	180.4	127.8	+ 3.4	–56.5	+20.0	+37.7
Switzerland (Swiss Market)	5,146.2	5,422.6	3,675.4	+ 1.7	–38.8	+11.1	+17.1
United States (DJIA)	9,630.9	9,659.1	7,524.1	+ 1.7	–17.8	+15.5	+15.5
(S&P 500)	1,033.8	1,039.6	800.7	+ 1.5	–32.3	+17.5	+17.5
(NASDAQ Comp)	1,893.8	1,909.6	1,271.5	+ 3.4	–62.5	+41.8	+41.8
Europe (FTSE Eurotop 300)*	888.5	926.5	682.7	+ 1.6	–47.9	+ 3.7	+16.7
Euro area (FTSE Ebloc 100)*	754.6	800.8	565.7	+ 1.7	–51.3	+ 5.0	+18.3
World (MSCI)†	947.4	949.1	710.8	+ 2.0	–34.6	na	+19.6
World bond market (Citigroup)‡	576.9	583.9	518.6	nil	– 1.2	na	+ 9.8

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Oct 9th 2003
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2003	Current account The Economist poll % of GDP, forecast 2004	Exchange rate trade-weighted† 1990=100 Oct 8th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Oct 8th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2003‡
Australia	− 12.3 Aug	− 24.4 Q2	− 5.6	− 5.0	83.6	73.8	1.47	1.82	2.44	1.72	1.32	0.2
Austria	+ 0.1 Jun	+ 1.0 Jul	+ 0.2	nil	103.1§	100.8	0.85	1.01	1.42	–	0.77	-1.3
Belgium	+ 19.6 Jul	+ 11.2 Jun	+ 4.6	+ 4.6	103.3§	100.0	0.85	1.01	1.42	–	0.77	nil
Britain	− 72.2 Aug	− 28.6 Q2	− 1.1	− 1.5	98.1	106.3	0.60	0.64	–	0.70	0.54	-1.9
Canada	+ 39.1 Jul	+ 14.7 Q2	+ 1.7	+ 1.6	87.2	74.7	1.35	1.59	2.25	1.58	1.22	1.1
Denmark	+ 9.5 Jul	+ 6.0 Jul	+ 2.8	+ 2.6	106.4	103.2	6.34	7.53	10.6	7.43	5.73	1.6
France	+ 5.7 Jul	+ 22.0 Jul	+ 1.5	+ 1.5	106.8§	102.9	0.85	1.01	1.42	–	0.77	-3.6
Germany	+136.4 Aug	+ 53.0 Aug	+ 2.0	+ 1.9	104.5§	99.8	0.85	1.01	1.42	–	0.77	-3.7
Italy	+ 2.4 Jul	− 17.4 Jul	− 0.8	− 0.6	76.1§	73.3	0.85	1.01	1.42	–	0.77	-2.4
Japan	+ 96.2 Aug	+119.0 Aug	+ 2.8	+ 2.9	136.9	130.7	111	124	185	130	–	-7.7
Netherlands	+ 30.3 Jul	+ 15.1 Q2	+ 2.2	+ 2.7	102.8§	99.0	0.85	1.01	1.42	–	0.77	-1.6
Spain	− 46.7 Jun	− 20.9 Jun	− 2.4	− 2.2	77.3§	75.0	0.85	1.01	1.42	–	0.77	-0.4
Sweden	+ 16.4 Aug	+ 11.1 Q2	+ 4.1	+ 3.9	82.7	77.3	7.72	9.29	12.9	9.05	6.98	0.7
Switzerland	+ 5.7 Aug	+ 32.7 Q1	+10.6	+10.8	111.8	114.7	1.31	1.48	2.19	1.54	1.19	na
United States	−535.6 Jul	−528.7 Q2	− 5.3	− 5.5	98.8	114.9	–	–	1.67	1.17	0.90	-4.6
Euro area	+ 83.0 Jul	+ 39.0 Jul	+ 0.4	+ 0.5	90.7	82.2	0.85	1.01	1.42	–	0.77	-2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 13.8 Jul	+ 10.2 Jul	na	na	82.2§	78.9	0.85	1.01	1.42	–	0.77	3.1
Greece	− 24.3 Jul	− 11.6 Jul	na	na	59.7§	58.0	0.85	1.01	1.42	–	0.77	-1.0
Iceland	− 0.1 Aug	− 0.2 Q2	na	na	98.1**	89.0	76.3	87.2	127	89.4	68.9	nil
Ireland	+ 37.3 Jul	− 2.1 Q2	na	na	95.2§	89.3	0.85	1.01	1.42	–	0.77	-0.8
Luxembourg	− 3.4 Jul	+ 1.8 Q1	na	na	103.3§	100.0	0.85	1.01	1.42	–	0.77	0.2
New Zealand	− 1.4 Aug	− 2.9 Q2	na	na	97.3	88.4	1.67	2.08	2.79	1.96	1.51	0.8
Norway	+ 27.3 Aug	+ 26.5 Jun	na	na	97.9	106.7	7.01	7.40	11.7	8.21	6.33	11.3
Portugal	− 12.5 Jul	− 8.5 May	na	na	92.9**	90.0	0.85	1.01	1.42	–	0.77	-3.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, June average. ‡OECD forecast. **IMF, April average.

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Mergers and acquisitions

Oct 9th 2003
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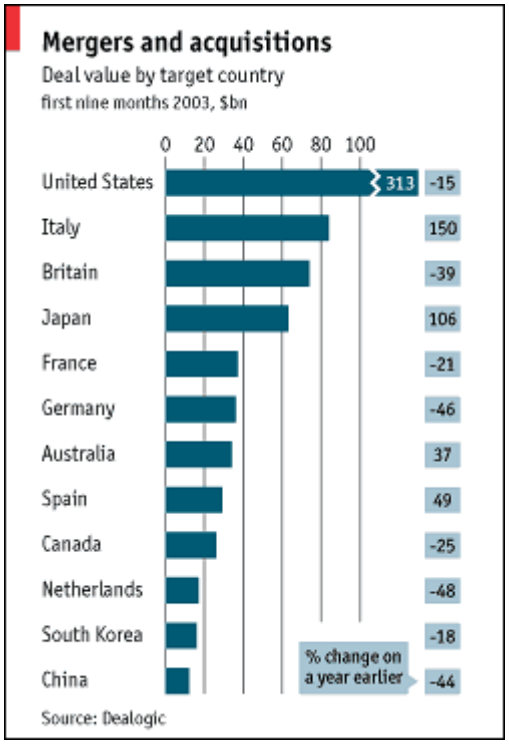

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Overview

Oct 9th 2003
From The Economist print edition

Moody's upgraded its rating of **Russian debt** to investment grade for the first time ever, opening the way to more foreign investment.

The ten members of the **Association of South-East Asian Nations** (ASEAN) agreed to transform their region into a free-trade area by 2020.

Three ASEAN members, **Indonesia**, **Malaysia** and **Thailand**, also received debt upgrades, from Standard & Poor's, which cited improved fiscal conditions and growing economic stability.

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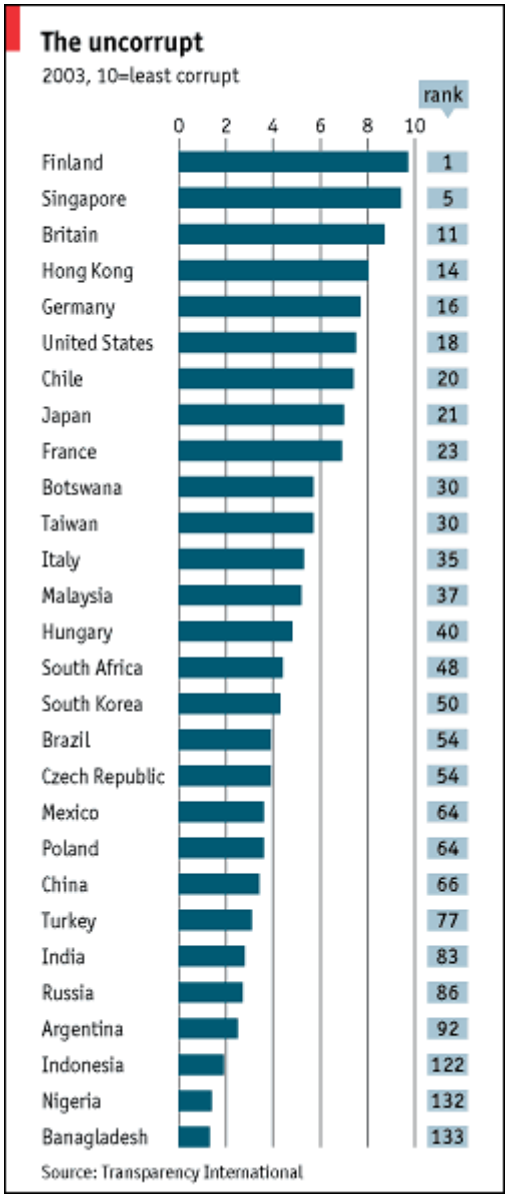
The uncorrupt

Oct 9th 2003
From The Economist print edition

Finland remains the least-corrupt country in the world, according to the latest annual index compiled by Transparency International, a Berlin-based organisation. The index, which measures perceived levels of corruption, focuses on the misuse of public office for private gain. The United States ranks as the 18th least-corrupt country, only a little less so than Chile. Botswana is reckoned to be less corrupt than Italy.



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Economy

Oct 9th 2003
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 6.7	Q2	+17.1	Aug	+ 0.9	Aug	+21.4	Aug	+35.4	2002	364.7	Aug
Hong Kong	– 0.5	Q2	–12.5	Q2	– 3.8	Aug	– 6.7	Aug	+18.4	Q2	112.1	Sep
India	+ 5.7	Q2	+ 5.6	Jul	+ 3.1	Aug	–12.6	Aug	+ 2.8	Q2	85.6	Sep
Indonesia	+ 4.1	Q3	+ 4.7	Jul	+ 6.2	Sep	+26.1	Aug	+ 6.7	Q1	32.3	Aug
Malaysia	+ 4.4	Q2	+ 4.6	Jul	+ 1.0	Aug	+17.5	Aug	+10.1	Q2	37.6	Aug
Philippines	+ 3.2	Q2	+ 4.4	Jul	+ 2.9	Sep	– 1.1	Jul	+ 3.0	Jun	12.8	Sep
Singapore	– 4.2	Q2	+10.3	Aug	+ 0.5	Aug	+14.0	Aug	+23.8	Q2	91.1	Sep
South Korea	+ 1.9	Q2	+ 1.5	Aug	+ 3.3	Sep	+11.6	Sep	+ 5.1	Aug	136.1	Aug
Taiwan	– 0.4	Q2	+ 5.3	Aug	– 0.2	Sep	+18.1	Sep	+26.9	Q2	185.7	Aug
Thailand	+ 5.8	Q2	+ 5.5	Aug	+ 1.7	Sep	+ 4.8	Aug	+ 8.7	Aug	37.4	Aug
Argentina	+ 7.6	Q2	+11.7	Aug	+ 3.5	Sep	+17.0	Aug	+10.2	Q2	13.4	Sep
Brazil	– 1.3	Q2	– 1.8	Aug	+15.1	Aug	+23.1	Sep	+ 3.5	Aug	47.8	Aug
Chile	+ 2.7	Q2	+ 2.1	Aug	+ 2.2	Sep	+ 2.8	Sep	– 0.8	Q2	15.3	Aug
Colombia	+ 2.0	Q2	+ 5.2	Jul	+ 7.1	Sep	– 0.3	Jun	– 2.1	Q1	10.4	Aug
Mexico	+ 0.2	Q2	– 1.9	Jul	+ 4.0	Aug	– 6.4	Aug	–11.5	Q2	51.5	Aug
Peru	+ 3.3	Jul	+ 1.0	Jul	+ 2.0	Sep	+ 0.4	Jul	– 1.2	Q2	9.0	Aug
Venezuela	– 9.4	Q2	–11.5	Jul	+26.6	Sep	+14.6	Q2	+ 9.3	Q2	12.8	Jun
Egypt	+ 3.1	2002†	+ 4.2	2002†	+ 4.4	Jul	– 7.1	Mar	+ 1.9	Q2	13.6	Jun
Israel	– 0.3	Q2	+ 0.4	Jul	– 1.1	Aug	– 6.3	Aug	nil	Q2	25.2	Sep
South Africa	+ 1.8	Q2	– 4.9	Aug	+ 5.1	Aug	+ 3.1	Aug	– 0.9	Q2	6.5	Aug
Turkey	+ 3.9	Q2	+11.9	Jul	+23.0	Sep	–18.7	Jul	– 4.7	Jul	29.8	Aug
Czech Republic	+ 2.1	Q2	+ 4.8	Jul	nil	Sep	– 2.4	Aug	– 5.0	Q2	25.6	Sep
Hungary	+ 2.4	Q2	+ 9.5	Aug	+ 4.7	Aug	– 3.5	Jul	– 4.3	Jul	12.8	Sep
Poland	+ 3.8	Q2	+ 5.8	Aug	+ 0.7	Aug	–10.4	Aug	– 5.5	Aug	31.6	Sep
Russia	+ 7.2	Q2	+ 5.5	Aug	+13.3	Sep	+54.9	Aug	+36.4	Q2	59.0	Aug
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 3.5	Q2	+11.0	Aug	+ 1.4	Sep	– 1.7	Jul	– 1.2	Q2	1.1	Jun
Latvia	+ 6.2	Q2	+ 2.4	Jul	+ 3.5	Aug	– 1.7	Jul	– 0.8	Jul	1.3	Jun
Lithuania	+ 6.7	Q2	na		– 0.8	Sep	– 2.4	Jul	– 0.9	Q2	2.7	Jun
Slovakia	+ 3.8	Q2	+ 3.7	Jul	+ 9.5	Sep	– 1.4	Aug	+ 1.0	Jun	10.1	Jun
Slovenia	+ 2.1	Q2	– 3.9	Aug	+ 5.0	Sep	– 0.4	Jun	+ 0.1	Jul	7.9	Jun
Pakistan	+ 3.4	2002†	+15.8	Nov	+ 1.8	Aug	– 1.1	Sep	+ 4.0	Q2†	9.8	Aug
Saudi Arabia	+ 1.0	2002	na		– 1.2	Jul	+41.8	2002	+11.7	2002	21.1	Jul

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Oct 9th 2003
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Oct 8th		Dec 31st 2002	
	Oct 8th	year ago	Oct 8th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.8	na	1,437.0	+0.3	+ 1.3	+ 1.3
Hong Kong	7.73	7.80	12.8	0.32	11,720.8	+4.4	+ 25.7	+ 26.8
India	45.3	48.3	75.3	4.49	4,634.9	+4.0	+ 37.2	+ 45.3
Indonesia	8,362	8,997	13,897	8.95	624.3	+3.0	+ 46.9	+ 57.3
Malaysia	3.80	3.80	6.32	3.10	759.6	+3.0	+ 17.5	+ 17.5
Philippines	55.0	52.7	91.4	7.81	1,298.5	+0.8	+ 27.5	+ 23.8
Singapore	1.72	1.79	2.87	0.75	1,733.9	+6.3	+ 29.3	+ 30.1
South Korea	1,150	1,242	1,911	3.88	722.8	+2.6	+ 15.2	+ 18.8
Taiwan	33.7	35.1	56.1	1.05	5,821.8	+4.3	+ 30.8	+ 34.8
Thailand	39.3	43.6	65.2	1.28	560.7	−1.6	+ 57.3	+ 72.7
Argentina	2.86	3.72	4.76	5.06	845.6	+2.1	+ 61.1	+ 89.3
Brazil	2.84	3.88	4.73	19.84	17,804.8	+7.4	+ 58.0	+ 96.7
Chile	644	751	1,071	2.88	7,187.3	+1.6	+ 43.2	+ 60.0
Colombia	2,885	2,853	4,795	7.77	2,157.1	+1.8	+ 34.1	+ 33.3
Mexico	11.23	10.20	18.7	5.47	7,812.1	−1.6	+ 27.5	+ 18.8
Peru	3.48	3.62	5.79	2.73	2,049.8	+3.4	+ 47.3	+ 48.7
Venezuela	1,598	1,492	2,656	17.60	17,180.5	+2.0	+114.3	+ 86.0
Egypt	6.16	4.63	10.23	6.61	10,808.6	+8.4	+101.2	+ 51.4
Israel	4.43	4.84	7.37	3.19	435.5	+0.5	+ 31.0	+ 40.4
South Africa	6.9	10.5	11.4	9.20	9,240.6	+4.2	− 0.4	+ 24.5
Turkey	1,381,500	1,647,500	2,295,915	28.00	15,147.8	+12.7	+ 46.1	+ 75.5
Czech Republic	27.1	31.0	45.1	2.05	614.2	nil	+ 33.3	+ 47.9
Hungary	215	249	357	9.31	9,753.1	+7.5	+ 25.1	+ 30.8
Poland	3.83	4.15	6.36	5.29	20,920.4	+8.2	+ 45.6	+ 45.9
Russia	30.3	31.7	50.4	16.00	629.0‡	+9.6	+ 66.2	+ 75.2
EMF (MSCI)*	1.00	1.00	1.66	na	398.6	+4.4	na	+ 36.5
EMBI+†	1.00	1.00	1.66	na	283.2	+1.1	na	+ 23.7

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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